Chapter 3 Business in a Borderless World

KEY TERMS AND DEFINITIONS

international business  The buying, selling, and trading of goods and services across national boundaries.

absolute advantage  A monopoly that exists when a country is the only source of an item, the only producer of an item, or the most efficient producer of an item.

comparative advantage  When a nation specializes in products that it can supply more efficiently or at a lower cost than it can produce other items.

Exporting  The sale of goods and services to foreign markets.

Importing  The purchase of goods and services from foreign sources.

balance of trade  The difference in value between a nation’s exports and imports.

trade surplus  A nation’s positive balance of trade, which exists when that country imports less than it exports.

infrastructure  The physical facilities that support a country’s economic activities, such as railroads, highways, ports, etc.

exchange rate  The ratio at which one nation’s currency can be exchanged for another’s or for gold.

import tariff  A tax levied by a nation on imported goods.

exchange controls  Restrictions on the amount of a particular currency that can be bought or sold.

quota  The maximum number of units of a particular product that can be imported into a country.

embargo  A prohibition on trade in a specific product.

dumping  When a country or business sells products for less than the cost of producing them.

cartel  A group of firms or nations that agree to act as a monopoly and not compete with each other, to generate a competitive advantage in world markets.

General Agreement on Tariffs and Trade (GATT)  A trade agreement that provides a forum for tariff negotiations and discussions of international trade problems with more than 100 member nations.
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<table>
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<tr>
<th>Term</th>
<th>Description</th>
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<tr>
<td>World Trade Organization (WTO)</td>
<td>The international organization that deals with the global rules of trade between nations.</td>
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<td>North American Free Trade Agreement (NAFTA)</td>
<td>Agreement that eliminates most tariffs and trade restrictions on agricultural and manufactured products to encourage trade among Canada, the U.S., and Mexico.</td>
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<td>European Union (EU)</td>
<td>A union of European nations established in 1958 to promote trade among its members.</td>
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<td>World Bank</td>
<td>An organization formed by the industrialized nations to loan money to developing countries.</td>
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<td>International Monetary Fund (IMF)</td>
<td>An organization established in 1947 to promote trade among member nations by eliminating trade barriers and fostering financial cooperation.</td>
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<td>countertrade agreement</td>
<td>Foreign trade arrangements involving the bartering of products for other products instead of currency.</td>
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<td>trading company</td>
<td>Company that buys goods in one country and sells them to buyers in another country.</td>
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<td>licensing</td>
<td>A trade agreement in which one company—the licensor—allows another company—the licensee—to use its company name, products, patents, brands, trademarks, raw materials, and/or production processes in exchange for a fee or royalty.</td>
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<tr>
<td>franchising</td>
<td>Form of licensing in which a company—the franchiser—agrees to provide a franchisee with elements associated with the franchiser’s business (name, logo, methods of operation, advertising, product, etc.) in return for a financial commitment and the agreement to conduct business in accordance with the franchiser’s standard of operations.</td>
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<td>contract manufacturing</td>
<td>An arrangement in which a foreign company produces a specified volume of a firm’s product to specifications and uses the domestic firm’s name on the final products.</td>
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<td>joint venture</td>
<td>The sharing of the costs and operation of a business between a foreign company and a local partner.</td>
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<td>strategic alliance</td>
<td>A partnership formed to create a competitive advantage on a worldwide basis.</td>
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<td>direct investment</td>
<td>The ownership of overseas facilities.</td>
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<tr>
<td>outsourcing</td>
<td>A form of direct investment that involves transferring manufacturing or</td>
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other tasks to countries where labor and supplies are less expensive.

**multinational corporation** A corporation that operates on a worldwide scale, without significant ties to any one nation or region.

**multinational strategy** Strategy that involves customizing products, promotion, and distribution according to cultural, technological, regional, and national differences.

**global strategy** Strategy that involves standardizing products, and possibly promotion and distribution for the whole world, as if it were a single entity.

STUDY QUESTIONS?

1. **Distinguish between an absolute advantage and a comparative advantage. Cite an example of a country that has an absolute advantage and one with a comparative advantage.**

   A nation with an absolute advantage is the only or most efficient producer of an item. A nation with a comparative advantage specializes in products that it can supply more efficiently; however, it is not the sole producer of those products.

   South Africa has an absolute advantage in diamond production, and the United States has a comparative advantage in agricultural products. The United States specializes in agricultural products such as wheat and cotton, but it is not the only producer of those products. Canada has a comparative advantage in automotive products even compared to the United States.

2. **What effect does devaluation have on a nation’s currency? What could have been the results?**

   Devaluations decrease the value of a currency in relation to other currencies. They make that country’s goods less expensive for foreign buyers.

   Revaluations increase the value of a currency in relation to other currencies. They make that country’s goods more expensive for foreign buyers, but foreign goods would cost the country’s consumers less.

   When Mexico devalued its currency, the number of Mexican products sold in the United States increased. The devaluation has favored tourism from the United States to Mexico.

3. **What effect does a country’s economic development have on international business?**

   Less-developed countries are likely to have much less infrastructure than developed countries, thus it may be difficult to develop operations in these countries. The wages offered for routine jobs in less-developed countries are lower than the minimum wages existing in industrialized countries. Consequently, many businesses from industrialized countries open assembly plants in less developed countries to reduce labor costs.

4. **How do political issues affect international business?**
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Political and governmental decisions can affect business through such barriers as tariffs, embargoes, terrorism, business favoritism, and so on.

5. **What is an import tariff? A quota? Dumping? How might a country use import tariffs and quotas to control its balance of trade and payments? Why can dumping result in the imposition of tariffs and quotas?**

An import tariff is a duty levied by a nation on imported goods. A quota is the maximum number of units of a particular product that can be imported into a country. Dumping occurs when a country or business sells products at less than what it costs to produce them.

A country, such as Turkey, could set higher import tariffs on another country’s products sold in Turkey, thus forcing Turkish consumers buying imported goods to pay a higher price. A quota may be set on the number of units that can be sold in Turkey. For example, import tariffs on Japanese televisions might mean that Japanese televisions might cost more. If quotas were established for Japanese televisions, only a certain number could be imported into Turkey. Either situation tends to protect domestic manufacturers. By selling more domestic products, the balance of trade and payments would be more favorable for Turkey, at least with Japan.

A country or firm that practices dumping harms local businesses by offering a product at a much cheaper price. In order to limit the access to its market by the dumping firm or country, the local government might decide to constrain the imports of the product considered. Thus, the government is likely to impose tariffs and quotas.

6. **At what levels might a firm get involved in global business? What level requires the least commitment of resources? What level requires the most?**

A firm can get involved in a variety of ways. Probably the smallest commitment is through exporting. Many companies first get involved in global business by exporting. A small company may market its products overseas directly, or it may deal with a middleman, commonly called an export agent.

The highest level of international business involvement is the multinational corporation. In between are trading companies, licensing and contract manufacturing arrangements, direct investment, and joint ventures.

7. **Compare and contrast licensing, franchising, contract manufacturing, and outsourcing.**

Licensing is a trade arrangement in which a licensor allows a licensee to use its company name, products, patents, brands, trademarks, raw materials, and/or production processes in exchange for a fee or royalty.

Franchising is a form of licensing in which the franchiser has a tighter control over the activities of the franchisee. The franchisee is provided with more support from the franchiser than the licensee. This support includes a name, logo, methods of operation, advertising, products, etc. In exchange for this support, the franchiser not only receives a financial commitment, but also can control the way in which the business is conducted.

Licensing and franchising lower the costs of businesses’ development by involving third parties in the
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opening and management of new facilities.

Contract manufacturing is an arrangement in which a foreign company produces a specified volume of a firm’s product to specifications and uses the domestic firm’s name on the final products. Contract manufacturing enables a company to benefit from the lower production costs offered in a foreign country without investing in that country.

Outsourcing, contrary to contract manufacturing, requires a direct investment on the part of the company. It involves transferring a specific set of tasks such as production or data entry to countries where labor or supplies are less expensive.