12-1 International Business and Trade

OBJECTIVES

- ***Describe common international business activities.***
- ***Identify methods for encouraging and measuring foreign trade.***

FOREIGN TRADE ACTIVITIES

Most business activities and financial transactions occur within a country's own borders. The making, buying, selling, and financing of goods and services within a country is called domestic business. In contrast, international business refers to business and financial activities necessary for creating, shipping, and selling goods and services across national borders. International business is often referred to as foreign or international trade.

The countries of the world are interdependent and so are their economies. The United States conducts trade with over 180 countries. Consumers have come to expect goods and services from around the world.

ABSOLUTE ADVANTAGE

Buying and selling among companies in different countries is based on two economic principles. An absolute advantage exists when a country can produce a good or service at a lower cost than other countries. This situation may result from the natural resources or raw materials of a country. For example, some South American countries have an absolute advantage in coffee production; Canada, in lumber sales; and Saudi Arabia, in oil production.

COMPARATIVE ADVANTAGE

A country may have an absolute advantage in more than one area. If so, it must decide how to maximize economic wealth. A country, for example, may be able to produce both computers and clothing better than other countries. The world market for computers, however, might be stronger. The country would better serve its own interests by producing computers and buying clothing from other countries. This situation, in which a country specializes in the production of a good or service at which it is relatively more efficient, is called comparative advantage.

IMPORTING

Goods and services bought from other countries are called imports. In the United States, imports account for the total supply of bananas, coffee, cocoa, spices, tea, silk, and crude rubber. In order to manufacture certain goods, U.S. companies must import tin, chrome, manganese, nickel, copper, zinc, and several other metals. Without foreign trade, many things you buy would cost more or would not be available at all.

EXPORTING

The goods and services sold to other countries are called exports. Just as imports benefit you, exports benefit consumers in other countries. Workers throughout the world use factory and farm machinery made in the United States. They eat food made from U.S. agricultural products and use chemicals, fertilizers, medicines, and plastics. Exports by U.S. companies create about one of every six jobs in this country.

TRADE BARRIERS

Government actions can create trade barriers, which are restrictions to reduce free trade. These political actions are known as formal trade barriers. In contrast, the culture, traditions, and religion of a country can create informal trade barriers. Informal barriers are not based on formal government actions but they do restrict trade. Three common formal trade barriers are quotas, tariffs, and embargoes.

Quotas. One action by governments to regulate international trade sets a limit on the quantity of a product that may be imported or exported in a given period of time. This limit is referred to as a quota. Quotas may be set for many reasons. Countries that export oil may put quotas on crude oil so that the supply will remain low and prices will stay at a certain level. Quotas may also be imposed by one country on imports from another to express disapproval of the policies or social behavior of that country. A quota can be set to protect an industry from too much foreign competition.

Tariffs. Another device that governments use to regulate international trade is the tariff. A tariff, also referred to as an import duty, is a tax that a government places on certain imported products. Suppose you want to buy an English bicycle. The producer charges $140, but our government collects a 20 percent tariff ($28) on the bicycle when it is imported. You will have to pay $168 plus shipping charges for the bike. The increased price may cause you to decide to buy a U.S.-made bike at a lower price.

Embargoes. If a government wishes to do so, it can stop the export or import of a product completely. This action is called an embargo. Governments may impose embargoes for many reasons. They may wish to protect their own industries from international competition to a greater degree than either the quota or the tariff will accomplish. The government may wish to protect sensitive products, particularly those important to national security. Like a quota, an embargo also may be imposed to express disapproval of the actions or policies of another country.

ENCOURAGING AND MEASURING TRADE

Expansion of foreign trade is an ongoing goal of most countries. Governments attempt to create jobs and enhance economic development through exporting.

ACTIONS TO ENCOURAGE TRADE

Specific government actions can promote international business activities. Common efforts to encourage international trade include free-trade zones, free-trade agreements, common markets, and regional trade organizations.

Free-Trade Zones. To promote international business, governments often create free-trade zones in their countries. A free-trade zone is a designated area, usually around a seaport or airport, where products can be imported duty-free and then stored, assembled, and/or used in manufacturing. Only when the product leaves the zone does the importer pay any taxes.

Free-Trade Agreements. A growing trend is for countries to establish free-trade agreements with other nations. With this arrangement, member countries agree to eliminate duties and trade barriers on products traded among them. Trade is then increased between members. A free-trade agreement may be between two or more countries. Examples include:

- The United States, Canada, and Mexico created the North American Free Trade Agreement (NAFTA) in 1993. This pact eliminates taxes on goods traded among the three countries and eases the movement of goods. NAFTA is designed to enlarge the markets and economic bases of the countries involved.
- The Central American Free Trade Agreement (CAFTA), which includes the Dominican Republic, has a similar purpose.

Common Markets. Countries may join together in a common market to promote more trade among them. In a common market, also called an economic community, members eliminate tariffs and other trade barriers, allow companies to invest freely in each member's country, and allow workers to move freely across borders. Common market members also have a common external duty on products being imported from non-member countries. Examples of common markets include:

- The European Union (EU), the Latin American Integration Association (LAIA), and Mercosur, the Southern Common Market, whose original members were Argentina, Brazil, Paraguay, and Uruguay. In recent years, other countries have joined as full or associate members. The goals are to expand trade among member nations and promote regional economic integration.

Regional Trade Organizations. In most regions of the world, countries unite to promote economic development and trade. Examples of these efforts include the following:

- The Association of Southeast Asian Nations (ASEAN) promotes political and economic cooperation among its 11 member countries. The goals of ASEAN include acceleration of economic growth, social progress, and cultural development.
- The Caribbean Community and Common Market (CARICOM) was established to provide for free movement of goods, labor, and capital among the member countries. CARICOM attempts to improve living and work standards and coordinate economic development and trade.
- Economic Community of West African States (ECOWAS) was organized to promote development among the 15 member countries. Economic issues (agriculture, trade, and infrastructure) along with social concerns (children, education, and public health) are the foundation of ECOWAS activities.

TRADE MEASUREMENTS

Like households, nations are concerned about balancing income with expenditures. When people buy more than their income allows, they go into debt. In the same way, when the businesses in a country import more than they export, they owe money to others. Foreign debt is the amount a country owes to other countries.

Balance of Trade. The difference between a country's total exports and total imports is called the balance of trade. Countries like to have a favorable balance of trade. That happens when they export more than they import. When a country exports (sells) more than it imports (buys), it has a trade surplus, and its trade position is said to be favorable. But, if it imports more than it exports, it has a trade deficit and its trade position is unfavorable. A country can have a trade surplus with one country and a trade deficit with another. Overall, a country tries to keep its international trade in balance. After a long history of a favorable balance of trade, the United States has had a trade deficit in recent years.

Balance of Payments. In addition to exporting and importing goods and services, other financial exchanges occur among nations. Money goes from one country to another through investments and tourism. For example, a citizen of one country might invest in a corporation in another country. A business may invest in a factory in another country. Or, a government might give financial or military aid to another nation. When tourists travel, they contribute to the flow of money from one country to another. The difference between the amount of money that comes into a country and the amount that goes out is called the balance of payments. A country's balance of payments can either be positive or negative. A positive or favorable balance of payments occurs when a nation receives more money in a year than it pays out. A negative balance of payments is unfavorable, which is the result of a country sending out more money than it brings in.

12-2 Economic Development and Monetary Systems

OBJECTIVES

- ***Describe factors that affect economic development.***
- ***Explain how countries influence foreign exchange values.***

ECONOMIC DEVELOPMENT

Every country and every individual continually makes decisions about the use of time, money, and energy. A nation's economic situation is a significant element in its international business and global financial activities.

ECONOMIC DEVELOPMENT FACTORS

In some countries, people travel to work on a high-speed bullet train to manage a computer network in a high-rise building. In other countries, people go by oxcart to a grass hut to operate a hand loom to make cloth for family members and people in their village. These differences in living and work environments reflect the level of economic development. The main influences on a country's level of economic development are:

- **Literacy Level**. Countries with better education systems usually have more productive facilities.
- **Technology**. Automated production, distribution, and communications systems allow for the efficient creation and delivery of goods, services, and ideas.
- **Agricultural Dependency**. An economy with an emphasis on agriculture will not likely have manufacturing to provide a high quantity and quality of products.

Another element that supports economic development is infrastructure, which is the transportation, communication, and utility systems of a nation. Countries with efficient transportation systems and modern telecommunications are better prepared for global business activities than nations with a weak infrastructure.

TYPES OF INFRASTRUCTURE

The infrastructure of a country provides the foundation for economic development and efficient business activities. Going beyond the basic facilities needed for financial transactions, infrastructure may be viewed from several perspectives.

- **Physical Infrastructure**. Refers to the transportation, communication, and utility systems that facilitate business activities, including computer systems and telecommunications facilities that are necessary for global business success.
- **Natural Infrastructure**. Involves climate, waterways, farmland, and other natural resources that contribute to a nation’s economic development. These natural resources can provide an advantage for countries when creating and distributing goods and services.
- **Social Infrastructure**. Family relationships, labor unions, religious influences, schools, and other social organizations often must be considered when interacting with customers, suppliers, investors, and employees.
- **Financial Infrastructure**. This element involves the availability and efficiency of a country's banks, financial markets, and other financial institutions.
- **Managerial or Entrepreneurial Infrastructure**. The ability of a nation's people to organize and implement business activities. For example, when McDonald's first opened a restaurant in Russia, company representatives worked with local businesspeople to teach managerial skills. They taught how to obtain, coordinate, and use the food products, workers, buildings, and equipment necessary to operate a fast-food restaurant.

LEVELS OF ECONOMIC DEVELOPMENT

The degree to which a country provides food, housing, health care, and other consumer needs is commonly viewed in three categories.

- **Industrialized Countries**. Nations with the greatest economic power have the ability to provide extensive goods and services. An industrialized country is a country with strong business activity that is usually the result of advanced technology and a highly educated population. Such countries have attained a high level of industrialization and an extensive network of financial institutions. Population is centered in large cities and suburbs rather than in rural areas. Industrialized countries are actively involved in foreign trade. Nations commonly described as industrialized include Canada, England, France, Germany, Italy, Japan, and the United States.
- **Less-Developed Countries**. Many countries of the world have a very low standard of living. A less-developed country (LDC) is a country with little economic wealth and an emphasis on agriculture or mining. About four billion people living in LDCs have an income of $2 or less per day. As a result, citizens often cannot afford adequate housing, food, and health care. This situation results in a high death rate among newborns, a shorter life expectancy than in other countries, and potential for political instability. Examples of LDCs include Afghanistan, Bangladesh, Bolivia, Chad, Ethiopia, Kenya, Liberia, Nepal, Nigeria, Pakistan, and Somalia. Future economic development for less-developed countries presents a challenge for all nations.
- **Developing Countries**. Between the extremes of economic development are the developing countries, attempting to evolve from less developed to industrialized. These nations are characterized by improving educational systems, increasing technology, and expanding industries. These factors result in an increasing national income. Examples of developing countries include Brazil, Bulgaria, Czech Republic, India, Mexico, and Thailand.

INTERNATIONAL CURRENCY

A major challenge faced by businesses involved in international trade is the varied currency systems in use around the world. Nations have their own banking systems and their own kinds of money. For instance, Russia uses the ruble; the European Union uses the euro; Brazil, the real; India, the rupee; and Saudi Arabia, the riyal. The value of a country's currency is important for international business success. If trading partners do not accept certain currency, the country may have to make payment in another currency. A currency that is not easy to exchange for other currencies is called soft currency. While the monetary unit serves as a medium of exchange in the home country, the currency has limited value in the world marketplace. In contrast, monetary units such the Japanese yen, the euro, the Swiss franc, and the U.S. dollar are accepted for most global financial transactions. These monetary units are examples of hard currency, which refers to monetary units that are freely converted into other currencies.

FOREIGN EXCHANGE RATES

The process of exchanging one currency for another occurs each day. The value of a currency in one country compared with the value of a currency in another is called the exchange rate. The value of currency, like most things, is affected by supply and demand.

FACTORS AFFECTING CURRENCY VALUES

Currency exchange rates among countries are affected by three main factors: the country's balance of payments, economic conditions, and political stability.

- **Balance of Payments**. When a country has a favorable balance of payments, the value of its currency is usually constant or rising. Increased demand for both the nation's products and its currency are the basis of this situation. In contrast, when a nation has an unfavorable balance of payments, its currency usually declines in value due to lower demand.
- **Economic Conditions**. When consumer prices increase and the buying power of the country's money declines, its currency will not be as attractive. Inflation reduces the buying power of a currency. High inflation in Brazil, for example, would reduce the demand for the real. Interest rates, the cost of using someone else's money, also affect the value of a country's currency. Higher interest rates mean more expensive products and lower demand among consumers. This, in turn, reduces the demand for a nation's currency, causing a decline in its value.
- **Political Stability**. Companies want to avoid risk when doing business in different nations. If a government changes unexpectedly to create an unfriendly business environment, a company may lose control of a factory or money on deposit in local banks. Political instability may also occur when new laws or regulations are enacted. These laws may not allow foreign businesses to operate as freely. Uncertainty reduces the confidence businesspeople have in its currency.

FOREIGN EXCHANGE CONTROLS

In an effort to maintain the value of its currency, a nation may place limits on the flow of money out of the country. Exchange controls are government restrictions to regulate the amount and value of a nation's currency. These controls can be in the form of either fixed exchange rates or limits on the amount and cost of currency. One common exchange control limits the amount of local currency a person can take out of a country.

12-3 International Financial Markets

OBJECTIVES

- ***Describe global markets for selling financial securities.***
- ***Explain other types of international financial markets.***

GLOBAL SECURITY MARKETS

International companies use stocks and bonds to finance global business activities. Stock and bond exchanges around the world create a network for issuing, buying, and selling equity and debt securities.

INTERNATIONAL STOCK EXCHANGES

While the New York Stock Exchange is the largest in the world, other major stock exchanges exist, including Euronext (Paris, Amsterdam, and Brussels), Bombay, Copenhagen, Dusseldorf, Istanbul, Milan, Rio de Janeiro, Seoul, Stockholm, Taiwan, Tel Aviv, Toronto, and Zurich.

Every hour of the day, investors buy and sell stocks. On the trading floor of the stock exchange and through computer systems, representatives of buyers and sellers interact to determine the prices of shares of stock.

Completely computerized stock exchanges, without trading floor representatives, are becoming common. These high-speed, low-cost automated systems are used by most major stock exchanges. Some of the world's largest screen-based systems for buying and selling global stocks are based in Europe. Computerized stock trading allows a broker in London to buy and sell stocks of multinational companies listed on stock exchanges in Istanbul, Rio de Janeiro, or Taiwan. The system allows investors to complete buy and sell orders anytime, day or night.

World Federation of Exchanges. This private organization exists to coordinate the activities of the hundreds of financial markets and stock exchanges around the world. The World Federation of Exchanges attempts to communicate among the exchanges to enhance the efficiency of these financial markets. This group also attempts to meet the needs of capital markets in emerging economies.

Global Stock Indexes. Investors use a stock index as an indication of market changes and trends. A global stock index is based on a group of stocks selected to reflect the overall progress of all stocks being represented. More than 50 stock indexes exist to communicate market trends, including the Toronto S&P, London FTSE, Tokyo Nikkei, DJ Pacific Pan-Asia, Milan S&P, Oslo All-Share, Kuala Lumpur Composite, and the Sao Paulo BOVESPA .

American Depository Receipt. Citizens of the United States are restricted from buying stocks in foreign companies. To allow U.S. investors to buy shares in corporations based in other countries, an American depository receipt (ADR) may be issued. The value of this document, which originates with a U.S. bank, is based on the value of the shares of the foreign stock. ADRs are traded on U.S. exchanges and are valued in U.S. dollars. With this procedure, the foreign stock shares are held in trust by the bank. While ADRs reduce transaction costs for investors, currency rate and economic risks still exist. The dividends and capital gains earned on the shares are converted to U.S. dollars, which are then distributed to investors.

International Mutual Funds International mutual funds exist to attract investors who wish to buy stock in hundreds of companies around the world. These investments are managed by a company that combines invested money from many people to purchase a portfolio of stocks. A major benefit of these mutual funds is diversification. By pooling money from many investors, a mutual fund manager is able to invest in many types of stocks and bonds, spreading out the risk for the investors. Global mutual funds eliminate the high brokerage commissions and high currency conversion fees that an individual investor might encounter. International funds reduce the risk that exchange rate changes may wipe out profits even when stocks increase in value. Other types of international mutual funds include regional funds. For example, a Latin America fund invests in companies with long-term growth in Central and South America. A Pacific fund would invest in companies in that region.

THE OVER-THE-COUNTER MARKET

Large companies that meet financial requirements of a stock exchange and are traded regularly are called listed stocks. In contrast, the over-the-counter (OTC) market is a network of stockbrokers who buy and sell stocks not listed on a stock exchange. The Nation al Association of Securities Dealers Automated Quotations (NASDAQ) is the major computerized trading system for OTC stocks in the U.S. The Unlisted Securities Market is the over-the-counter market for companies in England. In Germany, the Neuer Markt trades stocks of emerging companies in the European Union.

GLOBAL BOND MARKETS

Debt instruments such as bonds and notes are used by most companies, governments, and other organizations. These securities are bought and sold through financial markets in most major cities of the world.

International Bonds. Issuing bonds provides debt financing for companies and governments. The issue value of a corporate bond will vary based on the nation. The global bond market faces various problems, especially in emerging economies where economic and political uncertainty can affect interest rates and default potential. International financial analysts mention the following concerns regarding bonds issued in developing economies in an attempt to drive economic development.

- Projected returns from bonds can face strong uncertainty when issued by companies with no past record of financial success.
- Risk levels can quickly increase due to economic difficulties, political instability, and cultural differences.
- Local rating agencies may not have analysis techniques and reporting standards comparable to industrialized countries.
- The buy or sell decisions of institutional investors, such as mutual funds and insurance companies, can affect the bond market values for small, vulnerable companies.

Inflation-Linked Bonds. A debt security that can provide protection against economic uncertainty is the inflation-linked bond. This bond increases in value based on the rate of inflation. Examples of inflation-linked bonds are the Canadian real return bond (RRB) and the British inflation-linked gilt (ILG). With these securities, the loan principal of the bond increases with the inflation rate. Investors receive interest payments based on the inflated principal. At maturity, the repaid amount is the inflated principal.

International Asset-Backed Securities Market. The asset-backed security is a specialized type of global debt instrument. These bonds and notes are secured by various company assets. Common items used as collateral include loan receivables, accounts receivable, and other types of receivables. These asset-backed securities have short maturities and involve steady, definite cash flows, such as payments from loans or leases. The international asset-backed securities market has grown extensively in recent years, with continued growth expected. Most regions of the world will expand use of this financial security. In Asia, for example, some asset-backed securities are supported by the Asian Development Bank and others are funded by the Japanese government.

OTHER INTERNATIONAL FINANCIAL MARKETS

In addition to stock and bond markets, other global financial markets are in operation, including foreign exchange, futures, and options markets.

FOREIGN EXCHANGE MARKET

The value of a country's currency used to be set by its government. More recently, most countries use floating exchange rates, in which currency values change based on supply and demand. These values and the process of exchanging one currency for another occur in the foreign exchange market, which consists of banks and other financial institutions that buy and sell different currencies. Most large banks are part of the foreign exchange market and may provide currency services for businesses and consumers.

Travelers and businesspeople going outside of the United States can exchange dollars for the currencies of the countries they will visit. This exchange can be done at large banks, online, or at travel agencies that specialize in foreign currency services. When in another country, travelers can go to a currency exchange window at the airport, train station, or local bank and buy local currency. How much of the local currency they will get depends on the value of the two currencies at that time. Rates are posted at exchange windows, and there is a charge for exchanging currency.

FUTURES MARKET

If a company knows it will need a certain currency in the future, it can enter into an agreement to buy that monetary unit later at a price agreed upon today. Currency futures are contracts to purchase for a fee a foreign currency at today's rate with payment and delivery at a later date. For example, an Australian company needs 20 million yen in two months to pay for imports from a Japanese company. By buying a currency future contract, the importer will get the yen in two months at today's rate. This protects the Australian importer from having to buy the currency later at a higher price.

Farmers want to get a fair price for their grain. Food companies want to avoid paying high prices for grain that will be used to make breakfast cereals. By agreeing to a price now for delivery in the future (usually three or six months from now), a farmer is protected against receiving a lower price, while the cereal company is protected against higher costs.

The futures market allows investors to buy or sell contracts on the future prices of commodities, metals, and financial instruments. Futures markets involve contracts on corn, oats, soybeans, wheat, cocoa, sugar, oil, gold, silver, treasury bonds, and currencies-yen, euro, and Eurodollars.

OPTIONS MARKET

An option is the right to buy or sell a security or commodity at a specific price within a limited time period, usually three, six, or nine months. This contact can take one of two forms. A call option is the right to buy the item. In contrast, a put option is the right to sell some type of investment. When buying an option, you are not buying the investment (stock or commodity). You are only purchasing the right to buy or sell the investment in the future at a certain price. For example, a call option to buy a certain stock might allow the purchase of that stock at $40. This gives the investor the opportunity to buy those shares, before a certain date, for $40. This option would be used if the current market value of that stock is more than $40. However, if the stock sells for less than the option price, the investor will not exercise the option. The investor is not required to exercise an option. In general, the buyer of a call option hopes the price of the stock will rise. In contrast, an investor who buys a put option is expecting the market price to decline so the stock can be sold later at a higher price. Options markets exist around the world. In New York, Chicago, London, Tokyo, and elsewhere, investors are buying call and puts on everything from stocks and gold to soybeans and euros.

FOCUS ON: Carrefour's Cross-Border Cash Flows

The name of the Carrefour company, which is French for "crossroads," describes the company's global business activities. This French company, which is the largest retailer in Europe (and second largest in the world), has consumers crossing roads to get to their stores in 29 countries in Europe, Latin America, and Asia. Carrefour has more than 12,000 retail outlets operating under more than 20 different store names. Shoppers may encounter hypermarkets, supermarkets, convenience stores, and discount stores. The company offers everything from vegetables and frozen dinners to socks and banking. The diverse product line allows Carrefour to adapt to the needs of various cultures and geographic regions.

At the crossroads of southern Europe, Carrefour Italia has a significant presence with about 1,500 hypermarkets, supermarkets, and convenience stores. The company obtains over 90 percent of its fresh foods from local producers. This strategy keeps costs low and freshness and quality high. Carrefour brands in Italy include Terre D'italia and ScelgoBio.

Centros Comerciales Carrefour operates in Spain. Also called Carrefour Espana, this subsidiary owns or franchises about 3,000 hypermarkets, supermarkets, and discount stores under the Dia and MaxiDia banners.

In Latin America, Carrefour faced many cultural, economic, and political barriers. Despite setbacks, the company has been able to establish itself as the largest retailer in this region. Countries where Carrefour has strong market presence include Argentina, Brazil, Chile, Colombia, and Mexico.

In Asia, the company's success has been a result of careful planning and interaction with knowledgeable citizens. Facing regulatory risks along with currency crises, Carrefour effectively used local partners in the region.

12-4 Global Payments and Financial Risk

OBJECTIVES

- ***Describe global payment methods and financial documents.***
- ***Identify agencies that help companies reduce global financial risks.***

INTERNATIONAL PAYMENTS AND FINANCIAL DOCUMENTS

Sometimes when buying an item, you pay cash or write a check. Other times, you may buy the item on credit. In a similar way, global companies must decide how to pay for imported goods. Three types of payment methods are commonly used for international transactions: cash in advance, letter of credit, and sale on account.

CASH IN ADVANCE

Making payment before the shipment of goods can be risky for the buyer. When paying in advance, you may not receive the items or you may have difficulty obtaining a refund for damaged or returned goods. Cash in advance is not often used. This method may be required for first-time customers, small orders, or customers in high-risk countries.

LETTER OF CREDIT

A letter of credit is a financial document issued by a bank for an importer in which the bank guarantees payment. This payment method involves the importer paying for goods before they are received, but after the goods are shipped. This agreement, issued by the importer's bank, promises to pay the exporter a set amount when certain documents are presented. A bill of fading might be required as proof that the goods have been shipped.

SALE ON ACCOUNT

Almost every business buys or sells on account, allowing its regular customers to make payments in a certain time period, such as 30 or 60 days. Credit terms describe the time required for payment and other conditions of a sale on account.

OTHER GLOBAL FINANCIAL DOCUMENTS

Varied business environments may result in the use of other types of documents for foreign trade transactions.

Promissory Note. A promise to pay a set amount by a certain date is a promissory note. These notes are signed by buyers to confirm their intention to make payment. A promissory note communicates to both the buyer and the seller the amount of a purchase, the date by which it must be paid, and any interest charges.

Bill of Exchange. A written order by an exporter to an importer to make payment, usually through a third party, is a bill of exchange. The instructions to the importer include the amount, the due date, and the payment location, such as a bank or other financial institution. Electronic Funds Transfer Each day, more and more payments are being made online. Electronic funds transfer (EFT) moves payments through banking computer systems. After an importer receives the ordered goods, a bank can be instructed to transfer the payment for the merchandise to the bank of the exporter.

Commercial Invoice. Prepared by the exporter, a commercial invoice provides a description of the merchandise and the terms of the sale. This document includes details about the buyer, seller, merchandise, amounts, prices, shipping method, date of shipment, and terms of payment. Commercial invoices are also used at the port of entry to calculate any import duties that may be due.

Proof of Insurance. Often required in import-export transactions is proof of insurance. An insurance certificate explains the amount of insurance coverage for fire, theft, water, or other damage that may occur to goods in shipment. This document also lists the names of the insurance company and the exporter.

INTERNATIONAL FINANCIAL AGENCIES

Companies involved in global transactions must protect their merchandise and other assets. The services of several agencies are available to reduce foreign trade risk.

EXPORT-IMPORT BANK

The Export-Import Bank of the United States (EXIM) is a U.S. government agency that helps finance the export sales of U.S. products. EXIM provides loans to exporters, along with loan guarantees and export credit insurance. An exporting company can purchase an export credit insurance policy from EXIM that will provide 100 percent political risk protection for international sales, including protection from foreign governments that refuse to convert local currency to dollars. EXIM also covers damage or destruction of a shipment caused by wars, revolutions, and civil disorders.

OVERSEAS PRIVATE INVESTMENT CORPORATION

The Overseas Private Investment Corporation (OPIC) provides investment insurance to U.S. companies that establish operations in developing countries. A company can protect its overseas investment by purchasing OPIC insurance to shield the company from several types of political risk, including expropriation and damage or destruction caused by war, revolution, terrorism, and sabotage. If any of these political actions occur, the business can file a claim with OPIC to recover its losses.

FOREIGN CREDIT INSURANCE ASSOCIATION

One financial hazard of conducting business in other countries is not receiving payment. Credit risk insurance provides coverage for loss from non-payment for delivered goods. Credit risk insurance is available through the Foreign Credit Insurance Association (FCIA), a private association that insures U.S. exporters. FCIA enables exporters to extend credit to overseas buyers. Credit insurance covers 100 percent of losses for political reasons, such as war, asset seizure, and currency inconvertibility. This insurance covers up to 95 percent of commercial losses, such as non-payment due to insolvency or default. About 200 banks in the United States have purchased policies from FCIA and can insure loans made to U.S. exporters.

FOCUS ON: Bribery and Gift Giving

In the United States, it is considered unethical for a businessperson to pay bribes to government officials or to other businesspersons in exchange for favorable treatment such as the awarding of contracts. In fact, it is against the law, whether the recipient is an American or someone in another country. The Foreign Corrupt Business Practices Act of 1977 outlawed the payment of bribes by Americans to foreign officials, companies, or individuals. At times, not paying bribes may put U.S. businesses at a competitive disadvantage.

Companies in some regions of the world commonly use payoffs to gain access to new markets. Some countries consider bribes to be tax-deductible business expenses. U.S. companies can face heavy fines and prison sentences when U.S. laws are violated. But sometimes companies cave in to local customs. A U.S. computer company offered Chinese journalists the equivalent of $12 to attend its news conference. The company said the money was for taxi fares; but the amount was equal to a week's pay for some journalists.

While it is relatively easy to outlaw bribes, it is much harder to define the difference between a bribe and a gift given as a token of appreciation. Gift giving among businesspeople is relatively limited and infrequent in the United States and Canada. In other cultures it is very common and regarded as entirely appropriate. Many organizations have policies that limit the monetary value and type of gifts that are acceptable. A social dinner invitation is usually meant to influence the recipient's behavior, even if in a subtle way. As. more countries recognize how harmful bribes are to economic progress, the practice is ending.

Chapter Summary

- ***A country that can produce a good or service at a lower cost has an absolute advantage. A comparative advantage exists when a country produces a good or service at which it is more efficient. Items bought from other countries are imports. Items sold to other countries are exports. Some formal trade barriers are quotas, tariffs, and embargoes.***
- ***Free-trade zones, free-trade agreements, common markets, and regional trade organizations encourage international trade. The difference between a country's total exports and total imports is its balance of trade. Balance of payments is the difference between the amount of money that comes into a country and the amount that goes out.***
- ***An industrialized country has strong business activity resulting from advanced technology and a highly educated population. A less developed country (LOC) has little economic wealth and an emphasis on agriculture or mining. Developing countries are attempting to evolve from less developed to industrialized.***
- ***The value of a country's currency is affected by the nation's balance of payments, economic conditions, and political stability.***
- ***The World Federation of Exchanges coordinates financial markets and stock exchanges around the world. International mutual funds allow investors to buy stock in companies around the world. The global bond market is used to issue and trade debt securities.***
- ***Floating exchange rates are set in the foreign exchange market. The futures market allows investors and others to buy or sell contracts on the future prices of commodities, metals, and financial instruments.***
- ***Three types of payment methods are used for international transactions: cash in advance, letter of credit, and sale on account. Other global financial documents include promissory notes, bills of exchange, electronic funds transfer, commercial invoices, and proof of insurance.***
- ***The Export-Import Bank of the United States (EXIM) helps finance the export of U.S. products. The Overseas Private Investment Corporation (OPIC) provides investment insurance to U.S. companies that establish operations in developing countries. Credit risk insurance is available through the Foreign Credit Insurance Association (FCIA).***