UNIT 2
ORGANIZING FOR INTERNATIONAL BUSINESS

CHAPTER 5
Structures of International Business Organizations

CHAPTER 6
Importing, Exporting, and Trade Relations

CHAPTER 7
Foreign Exchange and International Finance

CHAPTER 8
Legal Agreements Around the World

CHAPTER 9
Global Entrepreneurship and Small Business Management
IF YOU WERE THERE

Suppose you were born in the late twentieth century in the city of Djakarta on the island of Java in Indonesia. Indonesia is a 13,677-island archipelago located south of the Asian mainland. It was once known as the East Indies. Over 8 million people live in your city, speaking languages ranging from Bahasa Indonesian to Javanese. Your relatives on Sumatra work on offshore oil rigs, and you sell food to tourists.

Perhaps you would rather have been born in Japan. There you might live in Toyota’s company town, Toyota City, where you would attend a Toyota-owned school, live in a Toyota-built home, and eventually work in a Toyota facility. You would make an excellent salary, but you would live in a country that experiences 1,500 earthquakes per year.

Early Asian Civilizations

Archaeologists believe that one of the earliest Asian civilizations flourished from about 2500 to 1600 B.C. Its ruins lie in present-day Pakistan and India in the Indus River Valley. These ancient Asian cities included well-planned streets, large public buildings, and multistory houses with indoor bathrooms.

Our knowledge of early Chinese civilization comes from the discovery of oracle bones that were used instead of paper. Priests in the Shang Dynasty (1700 to 1000 B.C.) would scratch a question to their ancestors on an animal bone before firing the bone, forcing it to crack. The priest would interpret the pattern of cracks as an answer to the question.
China, Oldest Civilization in the World

China has the oldest continuous civilization in the world. Mountain barriers, the Gobi Desert, and large bodies of water have protected it from invasion and cultural influences for centuries. For added protection, The Great Wall in northern China was completed in about 200 B.C. By the 19th century A.D., a weak Chinese dynasty gave in to European demands for trading privileges, causing large sections of China to be claimed by Great Britain, France, Germany, Russia, and Japan. This control was the result of a series of unequal treaties that established the basic pattern for China’s relations with the West for the next century. The communist government of the People’s Republic of China (the ruling party since 1949) reacted to this western influence by isolating China. However, recent economic reforms have led to a more open policy.

Japan, From Isolation to a Global Economy

The Japanese archipelago consists of four main islands and thousands of smaller ones. Together these islands make up the modern nation of Japan. Japan’s history is rather brief when compared to that of India or China. By 500 A.D., it was ruled by emperors and powerful clans (noble families). The shoguns (great generals) took power in the twelfth century and created the shogunate (military government) that lasted until 1867.

Japan’s cultural development had some influence from the Chinese. In the sixth century, Prince Shotoku encouraged the Japanese to accept the Chinese political philosophy that stressed the importance of an orderly society with obedience to authority. The Chinese also brought Buddhism to Japan. Siddhartha Gautama (563-483 B.C.), known as Buddha, or “enlightened one,” founded Buddhism. The tradition teaches that you let go of desire by meditating and that, through this process of intense striving, you attain enlightenment.

Like the Chinese, the Japanese wanted to protect the purity of their culture by preventing trade with the West. However, in 1853, the United States sent Commodore Matthew Perry and four warships to Japan to force an end to Japan’s isolation. Instead of war, the shogun signed trade treaties with Britain, France, the Netherlands, Russia, and the United States.
By the twentieth century, Japan was competing actively in the global economy. With an expanding economy and population, Japan fought wars with Russia and China over control of Korea and Manchuria. By 1940, Japanese troops had taken the northern and eastern parts of China and Southeast Asia, where they gained access to rich deposits of oil, rubber, and other essential natural resources. The United States then cut off exports to Japan in response to its occupation of China. The Japanese navy attacked the U.S. naval base at Pearl Harbor in Hawaii on December 7, 1941. This pushed the United States into World War II.

The atomic bombs dropped on Hiroshima and Nagasaki in August of 1945 killed about 100,000 people. Many thousands more were injured, and Japan surrendered on September 2, 1945. Economic recovery began after the war, and the manufacture of products for export has helped to drive an economy that provides one of the highest standards of living in the world.

Southeast Asian Peninsula
The Southeast Asian peninsula juts out of the Asian continent south of China. Vietnam, a long narrow country, runs along the peninsula’s east coast. Like other countries in the area, Vietnam contains lush tropical rain forests and fertile river valleys. Stronger countries have dominated Vietnam throughout history. China ruled Vietnam for about 1,000 years, and it was a French colony from the 1880s until it was lost to the Japanese in World War II.

The French returned when the Japanese were forced out. After the Vietnamese defeated the French in 1954, negotiations divided the country into North and South Vietnam. About 500,000 U.S. soldiers were sent to Vietnam during the Cold War to prevent the communist-ruled North from taking over the South. However, the U.S. troops were forced out in 1973, and a unified Communist Vietnam was formed in 1975. By the 1990s, Vietnam’s per capita income was just $125 per year. The Vietnamese look forward to loans from the International Monetary Fund and closer relations with the United States to build their economy.

Other nations in Southeast Asia—such as Myanmar (formerly Burma), the Philippines, and Thailand—face continuing political unrest. Cambodia, Vietnam’s neighbor, suffered through years of repression and civil war. A communist government known as the Khmer Rouge killed between 1 and 2 million people in the late 1970s. As civil war continued in 1993, 90 percent of the country’s registered voters turned out for the first free elections in Cambodian history.
Australia and New Zealand constitute the continent of Australia in the Southern Hemisphere. Australia, about the size of the United States, was originally settled by the Aborigines who are thought to have migrated there from southeast Asia about 40,000 years ago. Great Britain used Australia as a penal colony from 1788 to 1839 and settled about 161,000 prisoners there. Other European settlers, attracted by gold mining and farming opportunities, settled the six colonies in Australia and gave the country its western traditions. Many of the prisoners also remained after their sentences had ended. Australia has vast deserts and mountain ranges, and its Great Barrier Reef extends over 1,200 miles on the northeast coast. New Zealand lies about 1,200 miles southeast of Australia. Maori people from other Polynesian islands first settled on New Zealand. Europeans, primarily from Great Britain, settled there in the eighteenth and nineteenth centuries. New Zealand is mountainous with fertile plains. Both New Zealand and Australia are noted for liberal social policies. New Zealand was the first country in the world to allow women to vote.

A Region of Contrasts
The Asia-Pacific Rim is a region of contrasts. People living in Australia, Japan, and New Zealand enjoy a stable economy, while political and economic instability has occurred in Pakistan, Bangladesh, and Laos. Food shortages and human suffering have been common for millions of people in these countries. The region is faced with various challenges. Indians seek relief from religious and ethnic violence. Young reformers battle political repression in China. Koreans struggle with reunification. Efforts to build modern industrial states compete with attempts to maintain cultural traditions and social customs.

Think Critically
1. Why do you think so many of the Asian countries resisted ties with Western countries?
2. How do the mountainous regions of Asia and Australia affect trade?
3. Research the history of China, and discover what inventions are attributed to it.
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Chapter 5

STRUCTURES OF INTERNATIONAL BUSINESS ORGANIZATIONS

5-1 Methods of Business Ownership

5-2 Operations of Global Businesses

5-3 Starting Global Business Activities
During the 20 years after it started as a trading company (sogoshosha) in 1870, Mitsubishi got involved in mining, banking, shipbuilding, and railroads. The company started as a zaibatsu (family-run conglomerate) and continued to expand into various types of business activities. In 1946, the organization divided into 139 separate entities. Twelve years later, Mitsubishi Trading established a division in the United States to export U.S. goods and to import raw materials to Japan.

As a result of growth and foreign investments, the company has expanded into many service areas and manufacturing. Today, Mitsubishi is involved in banking, insurance, real estate, glass production, cable television, clothing fibers, agricultural products, chemicals, steel, plastics, electrical equipment, paper mills, motor vehicles, mining, shipbuilding, energy, food, power plants, aircraft production, and information systems.

Based in Tokyo, the company has more than 48,000 employees serving customers through 35 offices in Japan and over 100 offices in other countries. In 1985, Chrysler and Mitsubishi formed a cooperative agreement to build automobiles in central Illinois. The company is also part owner in the world's highest-producing copper mine, located in Chile.

Think Critically
1. What economic and social factors contributed to the creation and expansion of Mitsubishi?
2. How might Mitsubishi expand its international business activities in the future?
3. Go to the Mitsubishi web site to obtain additional information about the company's structure and main business divisions.
Describe the advantages and disadvantages of a sole proprietorship.

Describe the advantages and disadvantages of a partnership.

Explain the characteristics of a corporation.

The Sole Proprietorship

Have you ever wondered how a business gets organized? Almost every company you can think of started small with the efforts of one or two people. Both Texas Instruments and Apple Computer started with two people who had an idea for a new business opportunity. As a business grows in size, the company is likely to expand its operations and increase the number of owners. Every business organizes as one of three types: sole proprietorship, partnership, or corporation.

Most companies in the world are started and owned by one person. In the United States, over 70 percent of all businesses are sole proprietorships. A sole proprietorship is a business owned by one person. Many of the stores, companies, and other businesses you see each day have a single owner, even though they employ many people.

For a person to start a sole proprietorship, three major elements are needed. First, the new business owner must have a product or service to sell. Second, money for a building, equipment, and other start-up expenses will be required. Third, the owner must know how to manage the business activities of the company or hire someone else who knows how.
Before you decide to organize your business as a sole proprietorship, you need to consider the advantages and disadvantages of this form of business organization.

**Ease of Starting** Obtaining a business license and meeting other minor legal requirements are usually the only steps needed to start a sole proprietorship. Your idea, funds, and willingness to accept the risk associated with running a business are all you need to get started. Throughout the world each day, thousands of people start companies that serve their customers and create employment opportunities.

**Freedom to Make Business Decisions** As a single proprietor, all company decisions are your own. As owner, you can run things yourself or hire others.

**Owner Keeps All Profits** The difference between money taken in and payments for expenses is called net income or profit. Since you are taking all of the risk, you receive all of the financial rewards.

**Pride of Ownership** As your own boss, you have the chance to see the results of your efforts. Many people like to have their own company so they do not have to work for someone else.

Even though there are advantages to running a business as a sole proprietorship, there are also disadvantages of this form of business organization.

**Limited Sources of Funds** The ability to raise money for a sole proprietorship is limited to the owner’s contribution plus loans. As a new business owner, lenders may see you as a risky borrower. Even if you get a loan, it is likely to have a high rate of interest resulting in higher costs for the business.

**Long Hours and Hard Work** Since many new and small companies find it difficult to compete against established businesses, you will probably put in many long hours. When you own your own business, you cannot call in sick or take a vacation unless you have dedicated employees you trust.

**Unlimited Risks** In other forms of business organizations, several owners share the risks. As the sole owner, you are responsible for all aspects of the enterprise. The owner has unlimited liability. **Unlimited liability** means that the owner’s personal assets can be used to pay for any debts of the business.

**Limited Life of the Business** If the owner dies or is unable to run the business, the enterprise will either cease to exist or be sold to someone else. When the business is sold, it becomes a different company with a new owner.

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**CheckPoint**

What is unlimited liability?
PARTNERSHIP

A partnership is a business that is owned by two or more people, but is not incorporated. A partnership may be organized when a company needs more money or the talents of additional people. Each owner, or partner, usually shares in both the decision making for the company and the profits. Partnerships can be formed for any type of business. Stores, manufacturing companies, and restaurants can be organized as partnerships. Law firms and many professional sports teams use this type of ownership format.

ADVANTAGES OF A PARTNERSHIP

Like a sole proprietorship, a partnership also has a number of important advantages.

**Ease of Creation** A partnership is easy to start. A written agreement is created to communicate responsibilities and the division of profits.

**Additional Sources of Funds** With several owners, a partnership can raise more capital, expand business activities, and earn larger profits.

**Availability of Different Talents** Many partnerships can take advantage of the different skills of people. One partner may be responsible for selling, another takes care of company records, while a third supervises employees.

DISADVANTAGES OF A PARTNERSHIP

Even though there are advantages to running a business as a partnership, there are also disadvantages of this form of business organization.

**Partners Are Liable** As with the sole proprietorship, a partnership has **unlimited liability**. Any or all of the partners may be held personally responsible for the debts of the business.

**Profits Are Shared among Several Owners** The written partnership agreement determines the division of profits. Even if an uneven workload occurs, the net income is divided based on the agreement.

**Potential for Disagreement among Owners** Differences in opinions are likely to occur in every work situation. Two or more people who work closely together may have disagreements. Some people suggest that you avoid going into business with friends or relatives to prevent possible personal conflicts.

**Business Can Dissolve Suddenly** When one partner dies or cannot continue in the partnership, the business must stop. At this point, a new company and partnership agreement must be created. This may not be easy since some of the company assets may have to be sold to buy the departing partner’s share of the business.

What is the purpose of a partnership agreement?
While sole proprietorships are the most common type of business in the United States, corporations account for nearly 90 percent of the sales, as shown in Figure 5-2. A corporation is a business that operates as a legal entity separate from any of the owners.

A corporation raises money for business activities through the sale of stock to individuals and organizations that wish to be part owners of the corporation. A stock certificate is a document that represents ownership in a corporation. A stock certificate is shown in Figure 5-3.

The owners of a corporation are called stockholders, or shareholders. Stockholders usually have two main rights. The first is to earn dividends, and the second is to vote on company policies. Many people buy stock in corporations to earn dividends, which are a share of company profits.

Stockholders also indirectly control the management of the company. A stockholder typically has one vote for each share of stock owned. The stockholders vote to elect the board of directors of the company. The board of directors hires managers to run the company.

Unlike sole proprietorships and partnerships, in which individual owners are responsible for any actions of the business, corporations act as a legal “entity” on behalf of the owners.
ADVANTAGES OF A CORPORATION

A corporation has several advantages when compared to partnerships and sole proprietorships.

More Sources of Funds
As a result of having many people interested in being part owners, corporations have an easier time raising funds than a sole proprietorship or partnership. This capital can be used for a company to purchase expensive equipment or to build large factories.

Fixed Financial Liability of Owners
The business risk of a corporation is spread among many owners. A company such as General Motors or McDonald’s has thousands of stockholders. Each person who buys a share of stock has limited liability, which means stockholders are only responsible for the debts of the corporation up to the amount they invested. Unlike sole proprietors and partners, people who become part owners of a corporation can only lose the amount of money paid for the stock.

Specialized Management
Most corporations can afford to hire the most skilled people to run the company. The board of directors of the corporation hires the president and other administrative employees.

Unlimited Life of the Company
Unlike a sole proprietorship or partnership, a corporation is a continuing entity. When stockholders die or sell out, the company still exists. Ownership just transfers to other people.

DISADVANTAGES OF A CORPORATION

Even though there are advantages to running a business as a corporation, there are also disadvantages of this form of business organization.

Difficult Creation Process
The organizers of a corporation must usually meet complex government requirements. A charter is the document granted by the state or federal government that allows a company to form a corporation.

Owners Have Limited Control
Unless you own a large portion of the stock, you are unable to influence the operations of a corporation. Small or family-held corporations may have only a few stockholders, but most large corporations are owned by thousands of people.

Double Taxation
Sole proprietors and partners pay individual income tax on their companies’ earnings. However, a corporation pays corporate income taxes as a separate entity. Then stockholders pay personal income tax on the dividends they receive. Therefore, corporate earnings are taxed twice.

GLOBAL BUSINESS

EXAMPLE

H ow do you spell inc.?

In the United States, you can tell that a business is a corporation if the abbreviation Inc. (meaning incorporated) follows the company name. In Canada, Japan, and the United Kingdom, Ltd. (for limited) is used, referring to the limited liability of the owners. The notation for a corporate form of business in various other countries is listed below.

France, Belgium
Germany, Switzerland
Italy
Denmark
Spain, Mexico, Brazil
Netherlands

Sarl
GmbH
Srl
A/S
S.A.
N.V.

Think Critically

1. Conduct an Internet search to find some corporations based in other countries.
2. What cultural factors might influence different corporate notations?

CheckPoint

What are the rights of the owners of a corporation?
5-1 METHODS OF BUSINESS OWNERSHIP

REVIEW GLOBAL BUSINESS TERMS

Define each of the following terms.

1. sole proprietorship
2. net income, or profit
3. unlimited liability
4. partnership
5. corporation
6. stock certificate
7. stockholders, or shareholders
8. dividends
9. limited liability
10. charter

REVIEW GLOBAL BUSINESS CONCEPTS

11. What are the advantages of a proprietorship?
12. What are the disadvantages of a partnership?
13. What are the disadvantages of a corporation?

SOLVE GLOBAL BUSINESS PROBLEMS

For each of the following situations, what type of business organization would you recommend?

14. A group of programmers in India plan to start a software company and sell stock to other investors.
15. A person in Italy who creates small home decorations as a hobby plans to start a business selling these items.
16. Three doctors in South Africa wish to share office space, staff, and equipment.
17. Three friends in Finland are opening a small store to sell sports equipment.

THINK CRITICALLY

18. “Because of the advantage of limited liability, every business should be organized as a corporation.” Do you agree? Explain.
19. Is buying stock in a corporation a good investment?

MAKE CONNECTIONS

20. BUSINESS Name a sole proprietorship, a partnership, and a corporation in your community. Speculate about why each of these businesses chose its form of organization.

21. LAW Conduct an Internet search to obtain information on other forms of business organization, such as a limited partnership and an S corporation. Prepare a presentation of your findings for the class.
Most businesses are organized as sole proprietorships, partnerships, or corporations. However, other types of business organization exist for special situations. Increasingly, many of them also engage in international business activities.

A municipal corporation is an incorporated town or city organized to provide services for citizens rather than to make a profit. You might think that a city would only engage in local activities. However, many cities have partnerships with cities in other countries, import goods and services, and engage in cultural exchanges.

Nonprofit corporations are created to provide a service and are not concerned with making a profit. Included in this category are churches, synagogues, and mosques, some hospitals, private colleges and universities, many charities, the American Red Cross, Boy Scouts of America, and The Salvation Army. Nonprofits provide a significant portion of the jobs in the labor force in some countries. These organizations employ over 6 percent of the total workforce in the Netherlands, Ireland, Belgium, Israel, United States, Australia, and Britain. Many local nonprofit organizations are affiliated with international organizations.
Nonprofit organizations are also referred to as nongovernmental organizations, or NGOs. In recent years, NGOs such as labor unions, environmental groups, and public interest organizations have taken action on various social and economic issues. Labor groups are concerned about lost jobs and safe working conditions, while environmental organizations work to protect clean air and water.

A cooperative is a business owned by its members and operated for their benefit. Consumer cooperatives may be formed by a group of people in a community or at a place of worship. The group is organized to purchase food or other goods and services at a lower cost than usual. Any profits are returned to the cooperative members. A credit union is a cooperative created to provide savings and loan services to its members.

MULTINATIONAL COMPANIES

In 1670, King Charles II of Britain granted a business charter to create a trading company named after English explorer Henry Hudson. The Hudson’s Bay Company started as an international fur trading enterprise and today operates nearly 500 stores throughout Canada.

Just as the Hudson’s Bay Company started as a global business, many firms today operate in several countries. A multinational company or corporation (MNC) is an organization that conducts business in several countries. MNCs are also called global companies, transnational companies, and worldwide companies.

Figure 5-4 shows an example of the global business operations that a multinational company might have.

Figure 5-4  A multinational company has business operations in different countries.
MNCs usually consist of a parent company in a home country and divisions or separate companies in one or more host countries. For example, Mitsubishi of Japan (home country) consists of 160 companies doing business in several countries (host countries). Whirlpool has manufacturing facilities in North America, South America, Europe, and Asia with products sold in more than 170 countries. Coca-Cola sells its products in about 200 countries.

Today, as a result of widespread international business activities, thousands of multinational corporations exist. Many of these companies are very large. Royal Dutch/Shell, Ford, Exxon, General Motors, Wal-Mart, General Electric, IBM, and Toyota each have annual sales that exceed the GDP of many countries in the world.

**MULTINATIONAL COMPANIES IN OPERATION**

Multinational companies get involved in global activities to take advantage of business opportunities in other geographic areas. The potential for MNCs to sell goods or services in other countries is the result of a competitive advantage held by a company. This edge can be the result of technology, lower costs, location, or availability of natural resources.

Another major activity of MNCs is adapting to different societies. Social and cultural influences along with political and legal concerns must be continually monitored. For example, if a company is not aware of changes in a country's tax law, the result could mean lower profits.

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**KOMATSU ABANDONS JAPANESE FOR ENGLISH**

When industrial giant Komatsu was founded in Japan, it marketed its products within the country. The Japanese language served Komatsu well as a means of communication. As Komatsu expanded and began to market its heavy equipment elsewhere in the region, it continued to rely primarily on Japanese. However, as Komatsu developed worldwide markets in direct competition with the likes of Caterpillar Tractor, the Japanese language proved to be a handicap. Its employees and customers increasingly were not fluent in Japanese, which created major communication problems. To better compete in the global marketplace, Komatsu decided that it needed to switch from Japanese to English. Now that transition is in process—even at the home office in Japan. To facilitate the conversion to English, Komatsu is providing its employees with English language lessons. Over time, Komatsu will reach its goal of being an English-speaking multinational organization.

**Think Critically**

1. Why did Japanese serve Komatsu reasonably well when it expanded into nearby countries?
2. What do you think would be some of the challenges for a business that abandons the language of the home country?
3. Why do you think Komatsu chose English to replace Japanese?
CHARACTERISTICS OF MULTINATIONAL COMPANIES

Multinational companies commonly have the following characteristics.

- **Worldwide Market View** They view the entire world as their potential market. Companies seek product ideas through foreign subsidiaries and obtain raw materials on a worldwide basis.

- **Standardized Product** Companies look for similarities among markets to offer a standardized product whenever possible.

- **Culturally-Sensitive Hiring** They use consistent hiring policies throughout the world but are also culturally sensitive to host countries. The companies recruit managers internationally rather than just from the organization's countries of operation.

- **International and Local Perspective** These businesses distribute, produce, price, and promote with both an international outlook and a local perspective.

CONCERNS ABOUT MULTINATIONAL COMPANIES

The presence of a multinational company can have many benefits for a host country—more jobs, products, services, and even improved roads created by the MNC. However, there are two main concerns about MNCs.

As a foreign company becomes a major business, the MNC’s economic power can make a host country dependent. Workers will depend on the MNC for jobs. Consumers will depend on the company for needed goods and services. The MNC could become a country's main economic entity.

When this occurs the MNC could start to influence and even control the country’s politics. The company may require certain tax laws or regulations that only benefit the powerful MNC. The regulation and control of global companies is likely to be an issue in years to come.

GLOBAL BUSINESS EXAMPLE

BUSINESSES EXPAND TO MALAYSIA

Since gaining independence in 1963, Malaysia has demonstrated a political stability that has made the country an attractive destination for many foreign investors. U.S. companies such as Colgate-Palmolive, Goodyear, and Texas Instruments have had a strong presence there. Malaysia's neighbors, however, are even larger investors. Taiwan and Japan have built and operate business facilities to produce manufacturing equipment, telecommunications equipment, and electronics products.

**Think Critically**

1. How does political stability encourage foreign investment?
2. Why have neighboring countries invested in Malaysia?
Economic development in a geographic area can result from unusual circumstances. Consider Australia in the late 1700s. At the start of the Industrial Revolution in Britain, food shortages, lost jobs, and strict laws contributed to an increase in crime and legal penalties. People were jailed for their inability to pay bills. (There was no bankruptcy protection in those days.) The British people wanted lawbreakers and debtors removed from their society. The newly independent United States no longer allowed British criminals to be sent there, so a new location was needed.

In 1787, Captain Arthur Philip of the Royal Fleet navigated 11 ships with 759 convicts to Port Jackson (now called Sydney) in Australia. One of the early governors of Australia was Captain William Bligh, who had gained notoriety when the crew of his ship, the H.M.S. Bounty, mutinied.

Australia continued to be used as a penal colony until 1840, when free settlers began to dominate the area. In total, about 160,000 convicts were sent to Australia over the years. The country gained its independence from Britain in 1901.

Think Critically
1. Conduct a web search for additional information about the history of Australia.
2. Explain how this situation resulted in economic development for Australia.

What are two concerns host countries have about multinational companies?
REVIEW GLOBAL BUSINESS TERMS

1. municipal corporation
2. nonprofit corporation
3. cooperative
4. multinational company or corporation (MNC)

REVIEW GLOBAL BUSINESS CONCEPTS

5. Give an example of a municipal corporation, a nonprofit corporation, and a cooperative.
6. What is the relationship between a home country and a host country?
7. What kinds of competitive advantages can a multinational company have?

SOLVE GLOBAL BUSINESS PROBLEMS

For each of the following situations, decide whether the situation reflects a characteristic of a multinational company.

8. A product is designed to meet the strictest consumer protection laws so that it will be marketable in any country.
9. Advertising themes are the same in all countries, but the language is changed.
10. A company hires host country citizens as managers as often as possible.
11. Each country is considered a separate market, and a product is formulated to be sold in a single country.
12. Products are shipped to other countries only by mail.

THINK CRITICALLY

13. How do nonprofit organizations benefit society?
14. Is it likely that a well-managed multinational company could be successful in every country in the world? Explain.
15. Describe ways a global company could provide social and economic benefits to a host country.

MAKE CONNECTIONS

16. CULTURAL STUDIES Why are nonprofit organizations more popular in some countries than others?
17. MATHEMATICS Go to the web site of a multinational company. Determine the percentages of the company’s sales for different regions of the world, such as Africa, the Middle East, and Asia.
GOALS

- Identify five low-risk methods for getting involved in international business.
- Discuss higher-risk methods for getting involved in international business.

**LOW-RISK METHODS FOR GETTING INVOLVED IN INTERNATIONAL BUSINESS**

Companies use eight main ways to get involved in international business, as shown in Figure 5-5. As you move up the steps, the firm has more control over its foreign business activities as well as more risk. For example, indirect exporting has less risk associated with it than a joint venture. However, a company has more direct control over its business dealings with a joint venture than with indirect exporting.

![Figure 5-5](https://via.placeholder.com/150)

*Figure 5-5* A company may choose from a variety of methods to get involved in international business.
INDIRECT EXPORTING
At first, a business organization may get involved with international business by finding a demand for its service or product without really trying. **Indirect exporting** occurs when a company sells its products in a foreign market without any special activity for that purpose.

During a sales meeting or another business encounter, for example, someone in a foreign company may show interest in your product. A buyer who represents several companies may tell a small manufacturing company about the need for its product in Southeast Asia. Since the company was not looking for foreign business opportunities, indirect exporting is sometimes called *casual* or *accidental* exporting. Indirect exporting makes use of agents and brokers who bring together sellers and buyers of products in different countries. This method of international business has minimum costs and risks. Many companies have started their foreign business activities using this method.

DIRECT EXPORTING
After sales increase and a company decides to get more involved in international business, the organization will probably create its own exporting department. **Direct exporting** occurs when a company actively seeks and conducts exporting. The company may still use agents or brokers from outside of the organization. However, a manager within the company plans, implements, and controls the exporting activities.

While direct exporting requires higher costs than indirect exporting, the company has more control over its foreign business activities. The risk is still relatively low because the firm does not have an extensive investment in the other country. The exporting process is discussed in greater detail in the next chapter.

MANAGEMENT CONTRACTING
Knowledge is a powerful tool in business. An ability to find business opportunities, coordinate resources, solve problems, and make productive decisions is a skill that will be in demand throughout your life. The abilities of managers to assist companies in developing countries are important exports for industrialized countries. A **management contract** is a situation in which a company sells only its management skills. This has a fairly low risk for a company since managers can usually leave a country quickly if the business environment becomes too risky. An example of management contracting may involve a hotel company that agrees to help hotel owners in other countries.

A variation of this type of agreement is *contract manufacturing*. This arrangement involves a company in one country producing an item for a company located in another country. This relationship allows a business to enter a foreign market without investing in production facilities. Contract manufacturing is usually considered as having low to moderate risk.
To produce items in other countries without being actively involved, a company can allow a foreign company to use a procedure it owns. Licensing is selling the right to use some intangible property (production process, trademark, or brand name) for a fee or royalty. The Gerber Company started selling its baby food products in Japan using licensing. The use of television and movie characters or sports team emblems on hats, shirts, jackets, notebooks, luggage, and other products is also the result of licensing agreements.

A licensing agreement provides a fee or royalty to the company granting the license. This payment is in return for the right to use the process, brand name, or trademark. The Disney Company, for example, receives a royalty from the amusement park it licensed in Japan. Licensing has a low monetary investment, so the potential financial return is frequently low. However, the risk for the company is also low.

Another method commonly used to expand into other countries is the franchise, which is the right to use a company name or business process in a specific way. Organizations contract with people in other countries to set up a business that looks and operates like the parent company. The company obtaining the franchise will usually adapt various business elements. Marketing elements such as the taste of food products, packaging, and advertising messages must meet cultural sensitivities and meet legal requirements.

Franchising and licensing are similar. Both involve a royalty payment for the right to use a process or famous company name. Licensing, however, usually involves a manufacturing process, while franchising involves selling a product or service.

Franchise agreements are popular with fast-food companies. McDonald’s, Burger King, Wendy’s, KFC, Domino’s Pizza, and Pizza Hut all have used franchising to expand into foreign markets.

**CheckPoint**

What are five relatively low-risk methods of getting involved in international business?
It is often true that business activities with higher risks also return greater profits to justify taking those risks. Joint ventures and foreign direct investments also give companies more direct control over its business operations than most of the less risky methods.

**JOINT VENTURES**

A partnership can provide benefits to all owners. One type of international partnership is the *joint venture*, an agreement between two or more companies from different countries to share a business project. A joint venture is illustrated in Figure 5-6.

The main benefits of a joint venture are sharing raw materials, shipping facilities, management activities, and production facilities. Some drawbacks are sharing profits and having less control.

Joint venture arrangements can share costs, risks, and profits in any combination. One company may have only 10 percent ownership and the other 90 percent. It depends on the joint venture agreement.

Joint ventures, also called *strategic partnerships*, can be used for any type of business activity. This arrangement is especially popular for manufacturing. Joint ventures between Japanese and U.S. automobile manufacturers have been common. For example, the Ford Motor Company entered a joint venture with Mazda Motor Corporation. Ford used Mazda-produced parts for several cars. Mazda set up assembly plants for Ford motor vehicles.

**FOREIGN DIRECT INVESTMENT**

As a company gets more involved in international business, it may make a direct investment in a foreign country. A *foreign direct investment (FDI)* occurs when a company buys land or other resources in another country. Real estate and existing companies are common purchases under this method. Many British, Japanese, and German companies own office buildings, hotels, and shopping malls in the United States.

Another type of FDI is the...
A Question of Ethics

STEALING SECRETS BY FOREIGN PARTNERS

Working relationships between foreign enterprises and companies in host countries can be strained by the loss of technology secrets. In a closed society (one with a centralized government), outside companies may be required to provide their local partners with computer hardware, software, and knowledge to operate these systems. However, often the technology is then borrowed and duplicated by the local company to start a new business.

Think Critically

According to the guidelines for ethical analysis, how will the actions of the government and companies in the host country affect the business and economy of the other partner?

wholly-owned subsidiary, which is an independent company owned by a parent company. Multinational companies frequently have wholly-owned subsidiaries in various countries that are the result of foreign direct investment. In the past, foreign companies have owned U.S.-based businesses such as Burger King, Pillsbury, and Green Giant.

To prevent economic control of one country by another, a nation may restrict how much of its land or factories may be sold to foreign owners. For example, some countries allow a foreign investor to own only 49 percent of companies in those countries.

General Mills brought popular brands, such as Trix and Golden Grahams, into the partnership. Nestlé, well known throughout the world, has an extensive distribution system and strong brand presence in grocery stores and supermarkets.

Cereal Partners Worldwide (CPW) is a joint venture between these two companies. Created in 1989, Cereal Partners Worldwide is now the second-largest cereal company outside of North America. CPW operates in more than 130 countries with more than 40 distinctive cereal brands. In addition to the well-known General Mills brands, CPW has created some cereal products for specific markets. The joint venture company sells Zucosos in Chile, Chocapic in Spain, and Snow Flakes in the Czech Republic. CPW makes it possible to buy Trix or Cheerios at a rural store in Chile as well as in a supermarket in Israel.

Think Critically

1. What factors influenced the creation of CPW?
2. What are some examples of products you use each day that might need to be adapted to other cultures?
3. Go to the web site of General Mills to obtain current information about the activities of CPW and other joint ventures of the company.

CheckPoint

How does risk of doing business internationally differ for exporting and direct foreign investment?
REVIEW GLOBAL BUSINESS TERMS

Define each of the following terms.

1. indirect exporting
2. direct exporting
3. management contract
4. licensing
5. franchise
6. joint venture
7. foreign direct investment (FDI)
8. wholly-owned subsidiary

REVIEW GLOBAL BUSINESS CONCEPTS

9. Why is management contracting a safe method for getting involved in international business?

10. What is the difference between licensing and franchising?

SOLVE GLOBAL BUSINESS PROBLEMS

For each of the following situations, tell what method the company is using for its global business activities.

11. A Vietnamese company shares production costs and profits of a chemical manufacturing enterprise with an Israeli company.

12. A British toy company allows a Japanese company to create clothing and school supplies with one of the British company’s doll characters on the products.

13. A company in Egypt has purchased 51 percent of the stock of a company in Peru.

14. A small food-packaging firm cannot afford to sell in other countries, so it asks an export agent to obtain orders for the company.

THINK CRITICALLY

15. What factors would affect how the parties in a joint venture divide future profits?

16. In what ways does a company making a direct foreign investment in a new factory have more control than a company engaged in direct exporting?

MAKE CONNECTIONS

17. CULTURAL STUDIES Visit a toy store, sporting goods store, or another kind of store that sells merchandise printed with logos or images belonging to other companies. List the items you see and any information on the tags or packaging that indicates a licensing agreement.

18. TECHNOLOGY Do an Internet search for “joint venture.” Select a site that describes a joint venture involving two countries. Write a report on the companies and countries involved, the products, and other major details about the joint venture.
5-1 METHODS OF BUSINESS OWNERSHIP

A. The advantages of a sole proprietorship are ease of starting, individual business freedom, owner gets all profits, and pride of ownership. The disadvantages are limited funds, potential long hours, unlimited liability, and limited life of the business.

B. The benefits of a partnership are ease of creation, additional sources of funds, and availability of different talents. The possible drawbacks are partners are each liable, profits are shared, potential for disagreement, and business can dissolve suddenly.

C. Advantages of a corporation are more sources of funds, limited liability, management availability, and unlimited life. Disadvantages include difficult creation process, owners’ limited control, and double taxation.

5-2 OPERATIONS OF GLOBAL BUSINESSES

A. Other forms of business ownership include municipal corporations, nonprofit corporations, and cooperatives.

B. Multinational companies take advantage of business opportunities in several geographic areas by adapting to cultural and economic influences in different societies. Multinational companies with a global perspective consider the entire world as their potential market. They look for similarities among markets in order to offer a standardized product whenever possible.

5-3 STARTING GLOBAL BUSINESS ACTIVITIES

A. Low-risk methods used for getting involved in international business include indirect exporting, direct exporting, management contracting, licensing, and franchising.

B. Higher-risk methods used for getting involved in international business are joint ventures, foreign direct investment, and wholly-owned subsidiaries.

Read the case at the beginning of this chapter, and answer the following questions.

1. What are the benefits and potential problems of a company being involved in many types of products and services?

2. Describe a joint venture that might be appropriate for Mitsubishi in the future.
### REVIEW GLOBAL BUSINESS TERMS

Match the terms listed with the definitions. Some terms may not be used.

1. A business owned by its members and operated for their benefit.
2. The difference between money taken in and expenses.
3. The owners of a corporation.
4. Selling the right to use some intangible property for a fee or royalty.
5. The situation in which a business owner is only responsible for the debts of the business up to the amount invested.
6. The document granted by government allowing a company to organize as a corporation.
7. A document that represents ownership in a corporation.
8. The selling of a company’s products in a foreign market without any special activity for that purpose.
9. An independent foreign company owned by a parent company.
10. The situation in which a business owner’s personal assets can be used to pay any debts of the business.
11. A business that operates as a legal entity separate from any of the owners.
12. A situation in which a company sells only its management skills in another country.
13. A share of corporate earnings paid to stockholders.
14. The right to use a company name or business process in a specific way.
15. An agreement between two or more companies from different countries to share a business project.
16. A company actively seeking and conducting exporting.
17. The purchase of land or other resources in a foreign country.
18. An organization that conducts business in several countries.

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Chapter 5  MAKE GLOBAL BUSINESS DECISIONS

19. List reasons why most companies in the world start out and remain sole proprietorships. How does being a sole proprietorship benefit or limit a company's ability to become involved in international business?

20. Describe a situation in which a partnership or sole proprietorship could raise capital to expand business activities more easily than a corporation.

21. Why do you think the government makes the creation of a corporation more difficult than the creation of other forms of business ownership?

22. Name goods and services that could be the basis for creating a consumer cooperative.

23. What are some ways a multinational company can have a competitive advantage over local businesses?

24. What types of restrictions might a foreign government put on a multinational corporation doing business in its country?

25. Describe actions a manager might take when (a) planning, (b) implementing, and (c) controlling a company's exporting activities.

26. What are some services companies could sell to other countries using management contracts?

27. How would a business that sells licenses and franchises control the image of the company name?

28. What are some concerns people might have about a company making many foreign investments in their country?

GLOBAL CONNECTIONS

29. GEOGRAPHY Locate examples of multinational companies in different countries. Create a map showing where the companies are based and the other nations in which the companies operate.

30. COMMUNICATIONS Interview a local business owner about the form of business organization used by his or her company. Ask the owner how the company got started, and ask for suggestions he or she could give to others who want to start a business.

31. HISTORY Conduct library research about a major foreign company and its home country. Obtain information on how the country's history may have influenced the development of the company.

32. CULTURAL STUDIES Describe how a multinational company might need to adapt its products to meet the traditions, customs, and cultural norms of various societies.

33. SCIENCE Collect advertisements, articles, and other information about multinational companies. Describe what natural resources and production processes would be necessary to create the products of these companies.
Select a company to work with. Make use of previously collected materials, or do additional research to get the information you need.

1. Describe how your company might have started as a sole proprietorship or a partnership. Explain the factors that may have influenced the owners’ decision to select this form of business organization.

2. If the company becomes a multinational corporation, what benefits and problems could result?

3. Describe appropriate international business opportunities for the company. What products and services would be most appropriate for different geographic regions? What economic, cultural, legal, or political influences must the company consider?

4. Which of the methods described in the final section of this chapter (see Figure 5-5) would be appropriate for the company to use for international business activities?

5. Explain the possible use of two or more of these methods for getting involved in international business.

6. Prepare a written report or present a short oral report (two or three minutes) that answers these questions. Or if instructed by your teacher, create a poster or scrapbook with pictures and information that answer these questions.

**MATHEMATICS** Conduct an opinion survey of students and others to determine their attitudes toward products and companies from other countries. Survey questions could include: (a) Which countries make the best products? (b) Do consumers benefit from being able to buy products from other countries? (c) Should our government restrict products from other countries? (d) Should foreign governments restrict U.S. products from entering their markets? Prepare a chart showing your results.

**CAREER PLANNING** Talk to someone who owns a business. Obtain information about the types of jobs the person had before becoming an entrepreneur.

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**THE GLOBAL ENTREPRENEUR**

**CREATING AN INTERNATIONAL BUSINESS PLAN**

Select a company to work with. Make use of previously collected materials, or do additional research to get the information you need.

1. Describe how your company might have started as a sole proprietorship or a partnership. Explain the factors that may have influenced the owners’ decision to select this form of business organization.

2. If the company becomes a multinational corporation, what benefits and problems could result?

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