ABIT

INTERNATIONAL BUSINESS (MBA 206)

International Business Environment (Module-1)

Mitrabinda Nayak

Definition

International business refers to the trade of goods, services, technology, capital and/or knowledge across national borders and at a global or transnational level. It involves cross-border transactions of goods and services between two or more countries.

International business is defined as a field of management training (that) deals with the special features of business activities that cross national boundaries.

International business is defined as transactions devised and carried out across international borders to satisfy corporations and individuals.

International business is much broader than international trade. It includes not only international trade (i.e., export and import of goods and services) but also a wide variety of other ways in which the firms operate internationally. International Management professionals are familiar with the language, culture, economic and political environment, and business practices of countries in which multinational firms actively trade and invest.

Features of International Business

1. **Flow of Capital Across Countries -** International business is shaped by the flow of capital across borders rather than by flow of goods and services. The trends in the international money market and capital market construct the

financial statement of the country like BoP and contribute in shaping the fiscal and monetary policies of the govt. The govt. in turn modifies its policies to determine the flow of capital across countries.

2. **Market Expansion** – Market expansion and deeper penetration in different markets is the major objective of International Business.

3. **Size of International Business** – The size of international business should be large, so as to make a deeper presence in the foreign and national market.

4. **Wider Scope** – The scope of International Business is wide and covers all aspects of the system like International Marketing, International Investment, Technology Exchange, Management of Foreign Exchange, International Finance, Management of International HR, Production, Logistics Management etc.

5. **Market Segmentation** – Usually International Business depends on market segmentation in terms of geographical segments to do business.

6. **Integration of economies** - International business integrates (combines) the economies of many countries. This is because it uses finance from one country, labour from another country, and infrastructure from another country. It designs the product in one country, produces its parts in many different countries and assembles the product in another country. It sells the product in many countries, i.e. in the international market.

7. **Benefits to participating countries** - International business gives benefits to all participating countries. However, the developed (rich) countries get the maximum benefits. The developing (poor) countries also get benefits. They get foreign capital and technology, rapid industrial development and more employment opportunities. All this results in economic development of the developing countries. Therefore, developing countries open up their economies through liberal economic policies.

8. **Special role of science and technology** - International business gives a lot of importance to science and technology. Science and Technology (S & T) help the business to have large-scale production. Developed countries use high technologies. Therefore, they dominate global business. International business helps them to transfer such top high-end technologies to the developing countries.

9. **International restrictions** - International business faces many restrictions on the inflow and outflow of capital, technology and goods. Many governments do not allow international businesses to enter their countries. They have many trade blocks, tariff barriers, foreign exchange restrictions, etc. All this is harmful to international business.

10. **Sensitive nature** - The international business is very sensitive in nature. Any changes in the economic policies, technology, political environment, etc. has a huge impact on it. Therefore, international business must conduct marketing research to find out and study these changes. They must adjust their business activities and adapt accordingly to survive changes.

Reasons for International Business

This can be classified into Pull factors and Push factors.

Pull Factors

(Companies are attracted towards IB)

- Growth
- Profitability
- Achieving Economies of Scale
- Risk Spread
- Economic integration and free
- Markets
- Emergence of WTO
- Unifying Effect and Peace

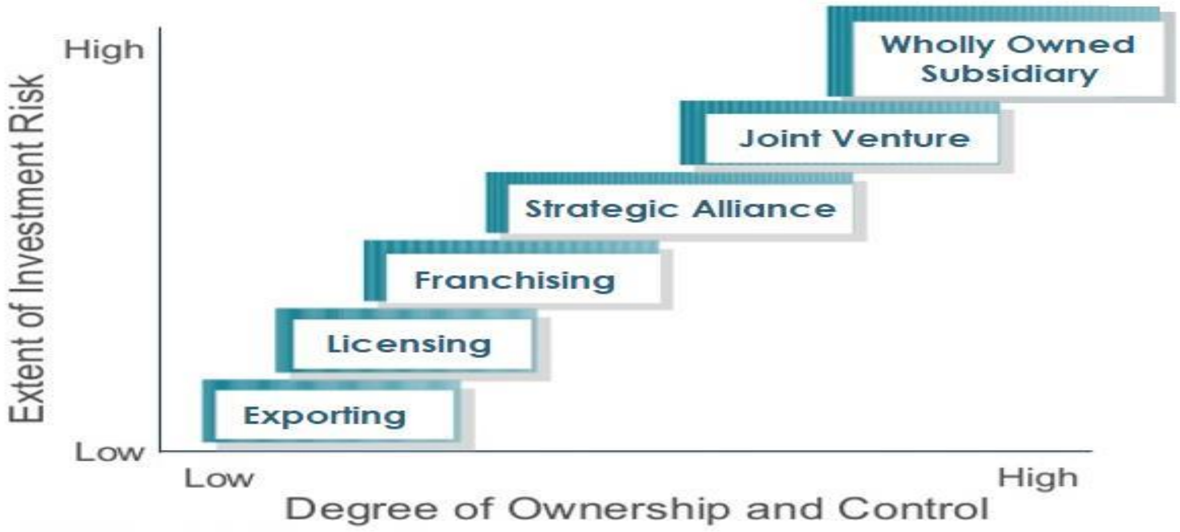
Push Factors

(Pressures in domestic factors which lead to IB)

- Uniqueness of product or service
- Marketing Opportunities due to life cycles
- Resource Utilization
- Competition and Costs
- Quality Improvement
- Govt. Policies and Regulations

Internationalization of business

Internationalization is a term used to describe the act of designing a product in a way that it may be readily consumed across multiple countries.This process is used by companies looking to expand their footprints beyond their counties of domicile, by branching out into international markets.Internationalization often requires modifying products to conform to the technical needs of a given country, such as creating plugs suitable for different types of electrical outlets.



Factors encouraging International Business

- To increase sales and acquire scarce resources
- To diversify sources of sales and supply
- Growth opportunities in other countries
- Potentially untapped markets
- Limited Domestic Market
- To increase market size
- To increase profit
- To reduce cost of transportation
- Encourage Cultural Transformation

Difference between Domestic and International Business

Basis	Domestic Business	International Business
1. Meaning	Domestic business refers to business transactions transacted within the geographical boundaries of a country	International business refers to the business transactions transacted in beyond the boundaries of a country
2. Participants in Business	People / organizations within the country participate in business activities	People/organizations outside the country participate in business activities
3. Mobility of Factor of Production	The factors of production i.e. labour,, capital, technology, material, etc., move freely within the boundaries of the country	The factors of production i.e. labour,, capital, technology, material, etc., move across the boundaries of the country.
4. Nature of Consumers	Consumers are relatively homogenous in nature in terms of culture, behavior ,taste, preferences, legal system, customs and practices, etc.,	Consumers are relatively heterogeneous in nature in terms of culture, behavior ,taste, preferences, legal system, customs and practices, etc. prevailing across the countries,
5. Business System	Domestic business is governed by the rules, laws, policies taxation system of a single country	International business is governed by rules, laws and policies ,tariffs and quotas etc., of multiple countries
6. Currency Used	Domestic business transactions are settled by local currency of a country.	International business transactions are settled by foreign currencies.
7. Mode of Transport	The goods involved in domestic business are mainly transported by roadways and railways.	The goods involved in international business is mainly transported by water and airways.
8. Risk Exposure	The risks involved in domestic business are relatively less.	The risks involved in international business are more due to distance, difference in socio-economic and political conditions. change in foreign exchanges value, etc.,
9. Scope of Market	The scope of market is limited to national boundaries of a country.	The scope of international business is very wide and extends beyond the frontiers of a country.
10. Payment of Excise duty	Payment of excise duty involves simple procedures and it is relatively low in domestic trade	The process of payment of excise is complicated in international business and the rate of excise duty is relatively high.

Advantages of International Business

- **Optimal use of natural resources -** International trade helps each country to make optimum use of its natural resources. Each country can concentrate on production of those goods for which its resources are best suited. Wastage of resources is avoided.
- **Availability of all types of goods -** It enables a country to obtain goods which it cannot produce or which it is not producing due to higher costs, by importing from other countries at lower costs.
- **Specialisation -** Foreign trade leads to specialisation and encourages production of different goods in different countries. Goods can be produced at a comparatively low cost due to advantages of division of labour.
- **Advantages of large-scale production -** Due to international trade, goods are produced not only for home consumption but for export to other countries also. Nations of the world can dispose of goods which they have in surplus in the international markets. This leads to production at large scale and the advantages of large scale production can be obtained by all the countries of the world.
- **Exchange of technical know-how and establishment of new industries -** Underdeveloped countries can establish and develop new industries with the machinery, equipment and technical know-how imported from developed countries. This helps in the development of these countries and the economy of the world at large.
- **Increase in efficiency -** Due to international competition, the producers in a country attempt to produce better quality goods and at the minimum possible cost. This increases the efficiency and benefits to the consumers all over the world.
- **Development of the means of transport and communication -** International trade requires the best means of transport and communication. For the advantages of international trade, development in the means of transport and communication is also made possible.
- **Free flow of Capital –** International business leads to free flow of capital within countries from surplus economies to needy economies.

- **Advantages due to Economies of Scale and Specialization –** A country will produce that product in which it has comparative advantage due to skilled labour, cheap raw material, latest technology etc. It will help in gaining economies of scale when it produces at large scale. Also, this creates division of labour and specialization.
- **Reduced Risk –** When a company is operating in nore than one country, both commercial and political risks are reduced to a certain extent due to diversification.
- **Identifying potential untapped markets –** International business allows a company to explore markets where demand exists but there is no supply of certain products. Here products can be sold at a greater profit than domestic markets.
- **Higher standard of living –** International business allows you to buy products and services which was not available earlier in the domestic market leading to higher standard of living.
- **Employment Generation –** International Business allows companies to shift their manufacturing facilities in other countries leading to employment generation in the host country.
- **International co-operation and understanding -** The people of different countries come in contact with each other. Commercial intercourse amongst nations of the world encourages exchange of ideas and culture. It creates co-operation, understanding, cordial relations amongst various nations.

Disadvantages of International Business

- **Impediment in the Development of Home Industries -** International business has an adverse effect on the development of home industries. It poses a threat to the survival of infant industries at home. Due to foreign competition and unrestricted imports, the upcoming industries in the country may collapse.
- **Economic Dependence -** The underdeveloped countries have to depend upon the developed ones for their economic development. Such reliance often

leads to economic exploitation. For instance, most of the underdeveloped countries in Africa and Asia have been exploited by European countries.

- **Political Instability –** International business is dependent on the political stability and the policies of the ruling govt. Changes in govt. or political instability has a negative impact on the entry, exit and functioning of international businesses.
- **Mis-utilisation of Natural Resources -** Excessive exports may exhaust the natural resources of a country in a shorter span of time than it would have been otherwise. This will cause economic downfall of the country in the long run.
- **Storage of Goods -** Sometimes the essential commodities required in a country and in short supply are also exported to earn foreign exchange. This results in shortage of these goods at home and causes inflation. For example, India has been exporting sugar to earn foreign trade exchange; hence the exalting prices of sugar in the country.
- **Exchange Instability –** Due to different status of payment of different countries at different time periods, its currency might be unstable in the market which leads to exchange rate instability and discourages International trade.

Approaches to International Business

Ethnocentric Approach

- The domestic company does not formulate any different marketing strategy for the foreign market.
- It views foreign markets as an extension to domestic market just like a new region.
- This approach can be used by a small company or a company which is new the field of international business but it may be harmful in long run because here the same product is marketed to foreign country without any modification.

Polycentric Approach

- The company adapts an altogether different approach from foreign markets.

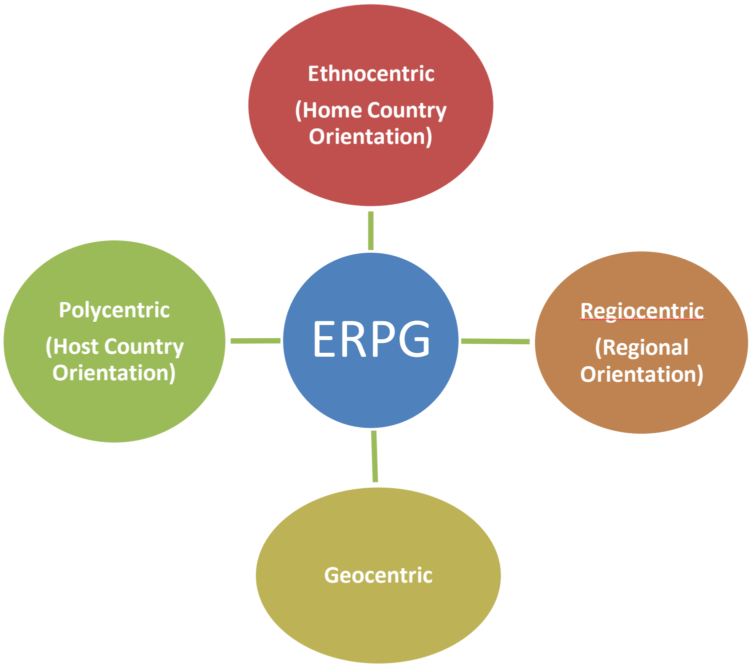
- They formulate strategies according to the environment of foreign country / host country.
- Companies establish foreign subsidiaries and empower its executives there which formulate marketing strategies.

Regiocentric Approach

- After working successfully in a foreign country, the firm now wants to enter into neighbouring countries in that region.
- In a company with a regiocentric orientation, management views regions as unique and seek to develop an integrated regional strategy.
- It markets more or less the same product to different countries but adapts different market strategies too.

Geocentric Approach

- A company with geocentric approach views the entire world as a potential market and tries to develop integrated world market strategies.



Globalization

In simple terms, globalisation is the economic, cultural and traditional share and communication between various countries across the world. It is a continuous socio-economic process which is a major step towards the development of the country.

Through globalization there is an intermingling and blend of various cultures, traditions and thoughts and interchange of ideas.

Globalization is a process of development of world into a single integrated economic unit. It refers to the changes in the world where we are moving away from self-contained countries and toward a more integrated world where the world is seen as one large market and one large economy, where the flow of goods and services are not restricted by government rules and regulations.

Definition – “The growing economic interdependence of countries worldwide through increasing volume and variety of cross border transactions in goods and services and international capital flows and also the more rapid and widespread diffusion of technology”.

Globalization of business is the change in a business from a company associated with a single country to one that operates in multiple countries.

Impact of Globalization – Lets take the example of a company whichproduces digital cameras. How would globalization impact your company?

The impact of globalization on business can be placed into two broad categories: **market globalization** and **production globalization**.

Market globalization is the decline in barriers to selling in countries other than the home country. This change will make it easier for your company to begin selling products internationally, since lower tariffs keep consumer prices lower and fewer restrictions when crossing borders makes it easier for a company to enter a foreign market. It also means that companies must consider other cultures when developing their business strategies and potentially adjust the product and marketing messages if they aren't appropriate in the target country. This may not be an issue in the camera industry, but a hamburger company entering India would definitely need to revisit their product and strategies to be successful!

Production globalization is the sourcing of materials and services from other countries to gain advantage from price differences in different nations. For example, you might purchase materials and components for your cameras from multiple countries and then assemble the product in yet another international location to reduce your costs of production. This change should lead to lower prices for consumers since products cost less to produce. It also impacts jobs, since production may shift from one country to another, usually from more developed countries to less developed countries with lower average wage rates.

Difference between Globalization and Internationalization

Although globalization and internationalization are used in the same context, there are some major differences.

- Globalization is a much larger process and often includes the assimilation of the markets as a whole. Moreover, when we talk about globalization, we take up the cultural context as well.
- Globalization is an intensified process of internationalizing a business. In general terms, global companies are larger and more widespread than the low-lying international business organizations.
- Globalization means the intensification of cross-country political, cultural, social, economic, and technological interactions that result in the formation of transnational business organization. It also refers to the assimilation of economic, political, and social initiatives on a global scale.
- Globalization also refers to the costless cross-border transition of goods and services, capital, knowledge, and labour.

Factors Causing Globalization of Businesses

There are many factors related to the change of technology, international policies, and cultural assimilation that initiated the process of globalization. The following are the most important factors that helped globalization take shape and spread it drastically.

1. **Improved transport –** This has made global travel easier. For example, there has been a rapid growth in air travel, enabling greater movement of people and goods across the globe. Over the last 25 years, sea transport costs have plunged 70%, and the airfreight costs have nosedived 3–4% annually. The result is a boost in international and multi-continental trade flows that led to Globalization.

2. **Containerisation** - From 1970, there was a rapid adoption of the steel transport container. This reduced the costs of inter-modal transport, making trade cheaper and more efficient.

3. **Growth of the Internet -** Expansion of e-commerce due to the growth of the Internet has enabled businesses to compete globally. Essentially, due to the availability of the Internet, consumers are interested to buy products online at a low price after reviewing best deals from multiple vendors. At the same time, online suppliers are saving a lot of marketing costs.

4. **The Reduction and Removal of Trade Barriers -** After World War II, the General Agreement on Tariffs and Trade (GATT) and the WTO have reduced tariffs and various non-tariff barriers to trade. It enabled more countries to explore their comparative advantage. It has a direct impact on globalization.

5. **Trade Negotiations -** The Uruguay Round of negotiations (1986–94) can be considered as the real boon for globalization. It is considerably a large set of measures which was agreed upon exclusively for liberalized trade. As a result, the world trade volume increased by 50% in the following 6 years of the Uruguay Round, paving the way for businesses to span their offerings at an international level.

6. **Growth of multinational companies -** Multinational Corporations (MNCs) have characterized the global interdependence. They encompass a number of countries. Their sales, profits, and the flow of production is reliant on several countries at once.

7. **The Development of Trading Blocs -** The 'regional trade agreement' (RTA) abolished internal barriers to trade and replaced them with a common external tariff against non-members. Trading blocs actually promote globalization and interdependence of economies via trade creation.

8. **Growth in economies of scale -** Firms exploiting gains from economies of scale to gain increased specialisation. This is an essential feature of new trade theory.

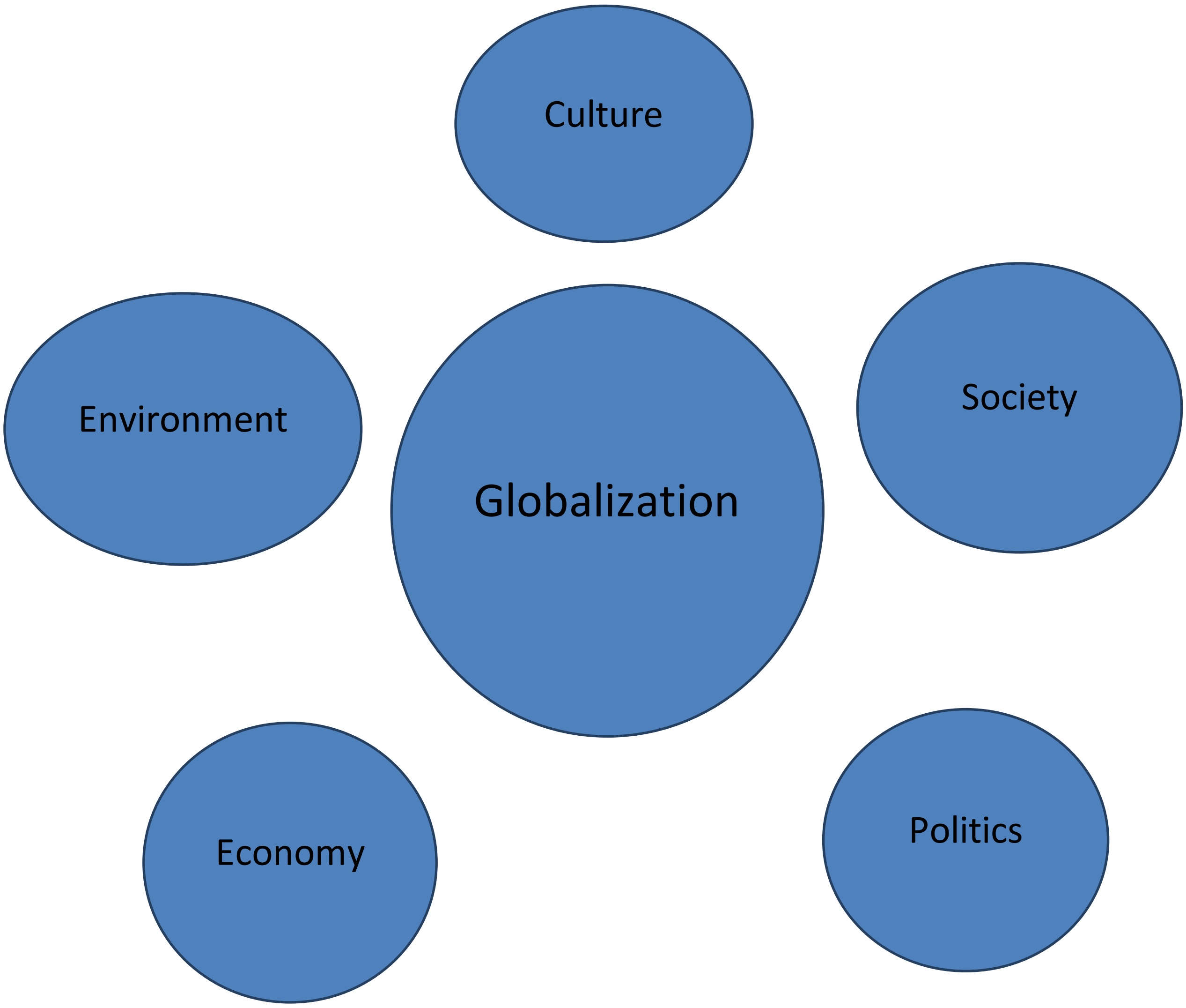
9. **Global trade cycle -** Economic growth is global in nature. This means countries are increasingly interconnected. (e.g. recession in one country affects global trade and invariably causes an economic downturn in major trading partners.)

10. **Improved mobility of capital** - In the past few decades, there has been a general reduction in capital barriers, making it easier for capital to flow between

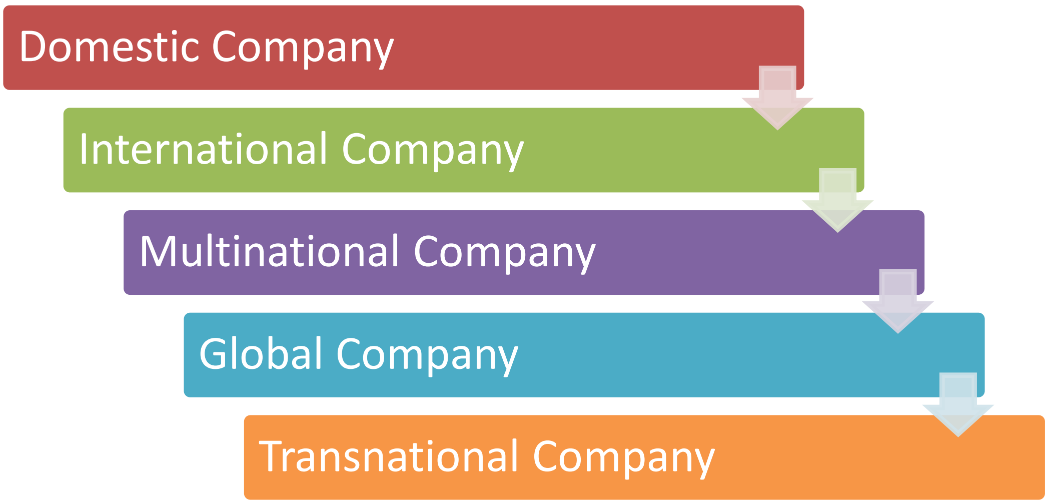
different economies. This has increased the ability for firms to receive finance. It has also increased the global interconnectedness of global financial markets.

11. **Increased mobility of labour** - People are more willing to move between different countries in search for work. Global trade remittances now play a large role in transfers from developed countries to developing countries.

Environments in Globalization



Stages of Globalization



Stage 1 : Domestic Company

- Domestic Company limits its operation, mission & vision to the national political boundaries.
- The company focuses its view in the domestic mkt opportunities, domestic suppliers, domestic financial companies, domestic customers etc.
- Also called as local company.
- All Indian companies are domestic companies but all domestic companies are not Indian companies.

Stage 2 : International Company

- International company is an enterprise which exists in one country but sells products in more than one countries.
- It holds the marketing mix constant and extends the operations to new countries.
- International companies have no FDI and make their own product or service only in their home country.
- In other words, they are exporters and importers.
- Eg:- Indian firms exporting textiles, jute, spices, nuts all round the world.

Stage 3 :Multinational Company

- A MNC is an enterprise operating in several countries but managed from one country.
- MNC have investment in other countries but do not have coordinated product offerings in each country. More focussed on adapting their products and services to each individual local market.
- The firm becomes the full fledged MNCs with the assembly of production facilities in several countries & regions of the world.
- E.g.- Nike, Mc Donalds, Sony

Stage 4 :Global Company

- The global country either produces in the home country and focuses on marketing these products globally or produces the products globally and focuses on marketing these products domestically.
- A global firm pursues a unified strategy to coordinate various international operations.
- Eg: - Hilton & Hyatt Hotels, Adobe, Cisco, 3M, American Express

Stage 5 :Transnational Company

- A transnational company essentially sheds their home nation's identity and acts as a stateless organization.
- They do not identify with one national home like a MNC.

- They are much more complex organizations and invented in foreign operations, R&D and marketing powers to each individual foreign market.
- It is an integrated global enterprise that links global markets at profit.
- Eg:- HUL, Starbucks, Walmart, Nestle, Coca-Cola

Advantages of Globalization of Businesses

1. Elimination of tariffs and creation of free trade zones with minimal or zero tariff.
2. Reduced transportation costs.
3. Reduction or elimination of capital controls.
4. Creation of subsidies for global businesses.
5. Harmonization of Intellectual Property laws across countries.
6. Supranational recognition of Intellectual Property Restrictions.
7. Wider choice of goods and services.
8. Creates competition for local firms and keeps costs down.
9. Globalization promotes specialization so countries can specialize in making products they are best at making.
10. Improved social and p0olitical links between countries.
11. Raises the standard of living as there are various alternatives and incomes.
12. It promotes growth of the economy.

Disadvantages of Globalization of Businesses

1. Replacement of traditional products with modern ones resulting in loss of employment for the traditional crafts and industry.
2. Companies across nation as need to be efficient to be able to compete and sustain n a global environment which leads to tough competition for local industries.
3. It imposes a threat to the very existence of domestic and small scale industries.
4. Cheap imports from developing nations lead to unemployment in developed countries where the cost of production is high.

5. Choosing to specialize in certain product s may lead to unemployment in other sectors which are not prioritised.

6. Despite the availability of online translators, language is still one of the major disadvantages of international trade. The marketplace is filled with examples of poorly translated products with names that got misconstrued in another language.

7. The cultural differences are the unwritten rules of commerce in the country that are hard to uncover and can be even more difficult to solve. For example, the word "yes," in Western cultures typically means agreement. In some Eastern cultures however, it can mean that the person understands what you are saying, but does not necessarily agree.

8. The wider a product is distributed, the more likely that it may be illegally copied by a competitor leading to Intellectual Property Theft. This can be in the form of proprietary information or market branding.

9. There is always a political risk of international trade. Governments and their policies change over time, and sometimes companies can get stuck in the middle with different regulations that may target their sales and customers.

Business Environment

Environment means surroundings, external objects, influences or circumstances under which someone or something exists. It can be said as anything which is surrounding the human survival.

Business Environment comprises of factors internal and external which have direct and indirect bearing on the activities of the business.

Nature of Business Environment

1. It is dynamic in nature
2. It creates uncertainty for business.
3. It provides opportunities and also poses threats.
4. It requires continuous watch and update.

Classification of Business Environment

A) Internal Environment
B) External Environment

A) Internal Environment

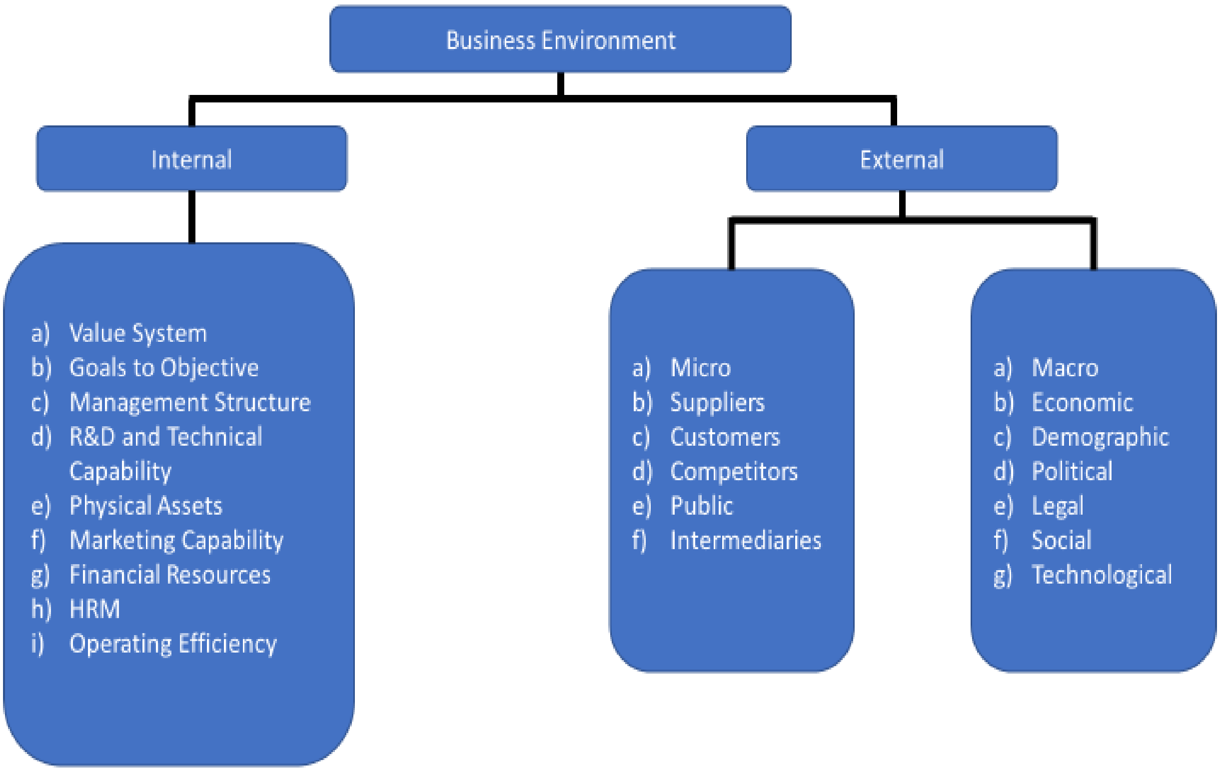
It refers to all the factors within the organization which imparts strength or creates workmen of strategic nature. Internal Environment is controllable and micro in nature. It can be modified and altered as it exists within the jurisdiction of the management.

B) External Environment

It comprises of all those factors that affect a business enterprise from outside and which are uncontrollable in nature. They cannot be modified or altered as per our demand and convenience. It is divided into :

i) **Micro External Environment** – It consists of external environmental factors of the company that affects the performance of the company like suppliers, wholesalers, retailers etc.

ii) **Macro External Environment** – It includes larger factors which affect the company like economic, demographic, technological, political etc.



International Business Environment

An international business environment is the surrounding in which international companies run their businesses. It brings along it with many differences.The International Business Environment is multidimensional including the political risks, cultural differences, exchange risks, legal & taxation issues. Therefore, IBEcomprises the political, economic, social & cultural, legal, & technological environments.Thus, it is mandatory for the people at the managerial level to work on the factors that make an International Business Environment.

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- Thus, it is mandatory for the people at the managerial level to work on the factors that make an International Business Environment.

Factors Affecting International Business Environment

A) Economic Environment
B) Cultural Environment
C) Political Environment
D) Technological Environment

A) Economic Environment

The economic environment relates to all the factors that contribute to a country's attractiveness for foreign businesses. The economic environment can be very different from one nation to another. Countries are often divided into three main categories: the more developed or industrialized, the less developed or third world, & the newly industrializing or emerging economies.

While analyzing the economic environment, the organization intending to enter a particular business sector may consider the following aspects:

- An Economic system to enter the business sector.
- Stage of economic growth & the pace of growth.
- Level of national & per capita income.
- Incidents of taxes, both direct & indirect tax.
- Infrastructure facilities available & the difficulties thereof.
- Availability of raw materials & components & the cost thereof.
- Sources of financial resources & their costs.
- Availability of manpower-managerial, technical & workers available & their salary & wage structures.

There are economic forces which play an important role in the Economic Business Environment. These are as follows :

a) Economic System
b) Primary Economic Indicators

a) Economic System

The Economic System is composed of people and institutions engaged in the process of production, distribution, and consumption of goods and services in a particular society including their relationship to productive resources. There are basically two forms of economic system, i.e., **Market Economy (Capitalist)** and **Socialist or Centrally Planned Economy.**

b) Primary Economic Indicators

The primary economic indicators help a firm to understand the financial and economic position of the country in which they want to invest. These indicators are as follows :

1. Income Levels and its distribution – The level of income is represented by the Gross National Product.

GNP = GDP + Income from Abroad

Per Capita Income = GNP / Total Population

The per capita income is the basic indicator of the purchasing power of the people.

2. Inflation – When inflation is high the production cost is also high. It affects the business class positively but has a negative impact on fixed wage earners.
3. Demographic and Consumption Patterns – Consumer behaviour affects the demand of a product. In a low income country, MNCS might find it difficult to sell highly priced products. An example is Amway in India.
4. Fiscal, Monetary & Economic Policies
5. Availability of Human & Physical Resources

B) Cultural Environment

The cultural environment is one of the critical components of the international business environment & one of the most difficult to understand. This is because the cultural environment is essentially unseen; it has been described as a shared, commonly held body of general beliefs & values that determine what is right for one group.

Culture refers to the entire set of social norms and responses that dominates the behaviour of a person's living in particular geographic or political boundaries. Beliefs & the values are generally seen as formed by factors such as the history, language, religion, geographic location, government, & education; thus firms begin a cultural analysis by seeking to understand these factors.

Features of Culture :

a) Culture is learned.
b) It is dynamic and changing.
c) It is not inherent but acquired from surroundings.
d) It consists of traditional ideas and values.
e) It is a behaviour shared by a group of people.

Strategies for dealing with Cultural Differences

a) **Cultural Assessment**–The culture of both home and host countries must be properly assessed. After evaluation of the cultural differences, the nature and degree of adjusted need to be listed out.
b) **Adaptation to Local Culture** – Three classes of adaptations are important. These are:
   i) **Adaptation in product policies** – This involves redesigning of market strategies that are in conformity with the host country market strategies.
   ii) **Individual adjustment** – This indicates that the managers have to undergo personal changes. They should learn the local language, local manner of dealing with the people.
   iii) **Institutional adaptation** – This type of adaptation incorporates changes in the very organizational structure and policies, so as to resemble the local culture.

c) **Communication**–Business should be continued in spoken and written language to avoid misunderstandings.

The following dimensions need to be considered while analysing the cultural environment.

- **Language** –Language is an important cultural tool for effectively conducting international business in the host countries. It is not just the spoken word but also symbolic communication through gestures, expressions, body movements. What the manager wants to convey must be clearly understood by his subordinates in the host country.

Word	**Connotation**
Homely	Friendly & comfortable in English but plain or ugly in the U.S
Brand name of American Motors - "Matador"	Killer in Spanish
For's low cost truck "Fiera"	Ugly old woman in Spanish
Tea	Word for dinner in Ireland

- **Attitudes & Values –** Attitudes andValues stem from moral or religious beliefs and are acquired through experiences. Pepsodent toothpaste did not sell well in Southeast Asia, as it promised white teeth. Black or yellow teeth are symbols of prestige there.

- **Colours −** It is important to know how people associate with colors. For example, purple is unacceptable in Hispanic nations because it is associated with death.

- **Customs and Taboos −** It is important for marketers to know the customs and taboos to learn what is acceptable and what is not for the marketing programs. For example, in the U.S, silence is taken as negation but not so in Japan. Burqa is a custom in Islamic countries.

- **Aesthetics −** There are differences in aesthetics in different cultures. This is concerned not only with a sense of beauty and good taste but also likes and dislikes in art, drama, music etc. Americans like suntans, the Japanese do not. In western societies wedding gowns are white in colour but in Asian countries white symbolises peace or sadness.

- **Time −** Punctuality and deadlines are routine business practices in the U.S. However, Middle East and Latin American people are far less bound by time constraints.

- **Religious Beliefs** − Religion can affect a product's labelling, designs, and items purchased. It also affects the consumers' values.For example, in India, the Hindus don't consume beef, and fast-food restaurants such as McDonald's and Burger King need to modify the offerings.

C) Political Environment

The political environment refers to the type of the government, the government relationship with a business, & the political risk in the country. This includes factors such as political ideologies, the nature of the government and constitution and the economic policies followed by the government.

a) Political Ideologies – Political ideologies constitute complex ideas, objectives, beliefs and theories that establish the socio-political program of the nation. Different political parties have different ideologies which is again based on the culture, ethics, religion, economic structure etc.

b) Political Structure – There are many different types of political systems like multi-party democracies, one-party states, constitutional monarchies, dictatorships (military & non-military). Therefore, in analyzing the political-legal environment, an organization may broadly consider the following aspects:

- The Political system of the business;
- Approaches to the Government towards business i.e. Restrictive or facilitating;
- Facilities & incentives offered by the Government;
- Legal restrictions for instance licensing requirement, reservation to a specific sector like the public sector, private or small-scale sector;
- The Restrictions on importing technical know-how, capital goods & raw materials;
- The Restrictions on exporting products &services;
- Restrictions on pricing & distribution of goods;
- Procedural formalities required in setting the business

There are four major effects of political environment on business organizations −

- **Impact on Economy** − The political conditions of a nation have a bearing on its economic status. For example, Democratic and Republican policies in the

US are different and it influences various norms, such as taxes and government spending.

- **Changes in Regulation** − Governments often alter their decisions related to business control. For example, accounting scandals in the beginning of the 21st century prompted the US SEC turn more mindful on the issues of corporate compliance. Sarbanes-Oxley compliance regulations (2002) were social reactions. The social environment demanded the public companies to be more responsible.
- **Political Stability** − Political stability effects business operations of international companies. An aggressive takeover overthrowing the government could lead to a disordered environment, disrupting business operations. For example, Sri Lanka's civil war and Egypt and Syria disturbances were overwhelming for businesses operating there.
- **Mitigation of Risk** − There are political risk insurance policies that can mitigate risk. Companies with international operations leverage such insurances to reduce their risk exposure.

c) Economic Rules of the Government

The government plays an important role in the economy of the world. Some of the important roles are :

➢ **Planning Role** - In this role the government aims to divert the limited resources of the country to the right purpose so as to achieve the larger planning goals.

➢ **Promotional Role**–In underdeveloped and developing countries where there is scarcity of entrepreneurial activities and infrastructural facilities, the government builds up and strengthens the infrastructure like power, transport, trading, marketing and other promotional activities.

➢ **Regulatory activities** – In this role the government extends from regulation of entry into business to the final results of a business. Government regulates the entry into businesses through licensing reservations, etc. Regulatory role of the government can be broadly classified into two categories:

i) Indirect Controls – They are monitored through fiscal and monetary controls like incentives and penalties.

ii) Direct Controls – They are discretionary control of government which is applied selectively from industries to industries.

➢ **Entrepreneurial Role** – In some countries the government plays the role of an entrepreneur by establishing, operating and managing business and bearing all risks. In underdeveloped and developing economies, public sector dominates in establishing of capital-intensive project like steel, iron, capital goods, etc. Here the private sector is reluctant to enter into huge investments demands, high risk-taking projects.

D) Technological Environment

Technological environment has direct influence on business. The type of technology in use, the level of technological advancements, adoption of new technology, technological policy etc have direct implications on the growth of business. Technology travels from advancement countries to developing countries by joint ventures, mergers and acquisitions, establishment of subsidiaries in developing countries and technological alliances.

Methods of Technology Transfer

1. **Turnkey Contract** – Transfer of technology in between home and host country takes place through turnkey contracts, which includes the supply of services like supply of goods, design particulars, creation, commissioning and supervision of a facility to the client.
2. **Licensing agreement** – Under this agreement licenser signs an agreement with no licences in another country to see the technological expertise of the licensor.
3. **Training and employment of technical expert**–Technological transfer can also take place by imparting the requisite training to suitable personnel or by employing foreign technical experts.
4. **Contracts for supply of equipment and machine** – It transfers the technology pertaining to equipment. It is often quite adequate for manufacturing projects.

There are many ways in which IT revolution would be beneficial to business like reducing the size of inventories, the delivery time of product, unproductive waiting time, stock outs, lost sales, rush orders, unproductive processing and paperwork, unnecessary movements like forward and backward tracking, bringing down overproduction etc.

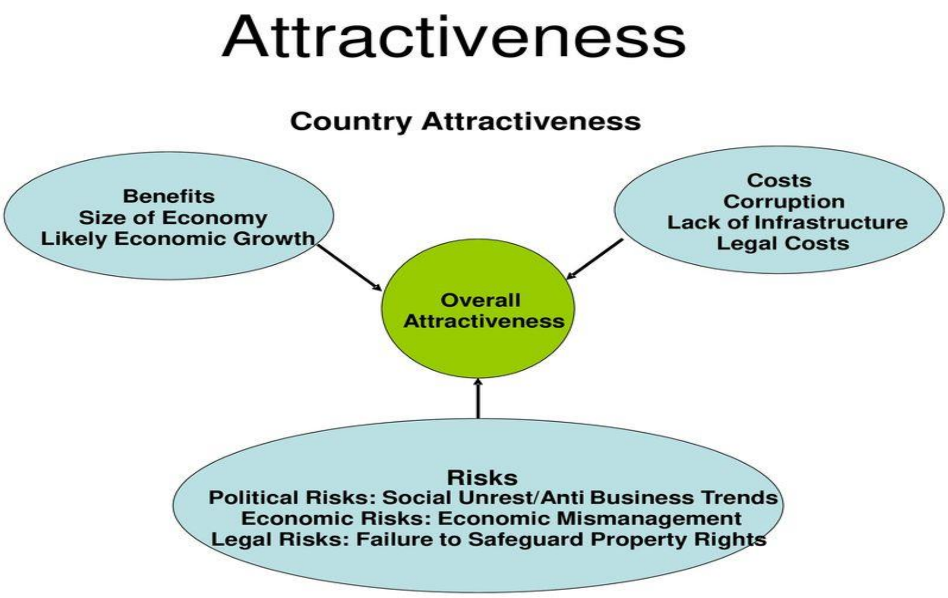
Country Attractiveness

Country attractiveness is a measure of a country's attractiveness to the international investors. In international business, investment in foreign countries is the most important aspect and hence firms want to determine how suitable a country is in terms of its external business environments.

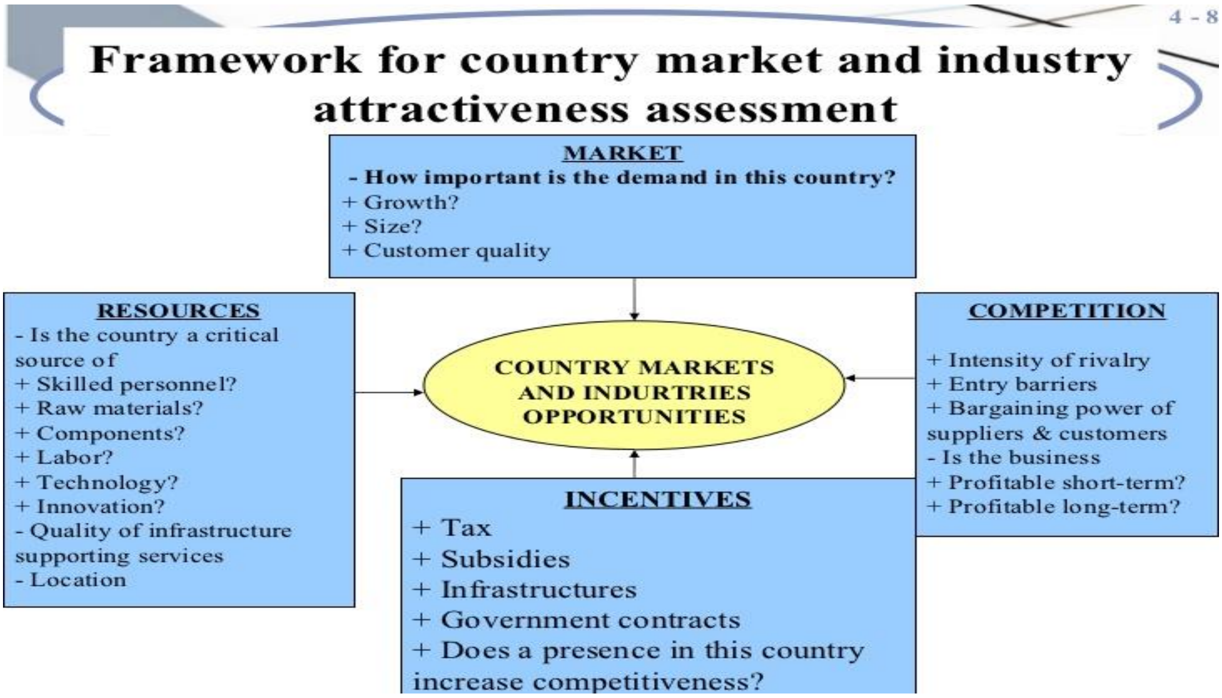
International business firms judge the risks and profitability of doing business in a particular country before investing and starting a business there. This judgment includes studying the environmental factors to arrive at a decision.

It is pretty clear that businesses prefer a country that is less costly, more profitable, and has fewer risks. Cost considerations are related with investment. Profitability is dependent on resources. Risks are associated with the environment and hence it is of prime concern.

Risks may be of various types. However, the general consensus is that a country that is more stable in terms of political, social, legal, and economic conditions is more attractive for starting a business.



Process of evaluating Country Attractiveness



Trade Strategies

Trade Strategy – It is the system of interference or intervention from the government.

Free Trade – It is the unrestrained flow of products, services, labour and capital, across the country's geographical boundaries, without any government intervention in the name of economic or regulatory barriers.

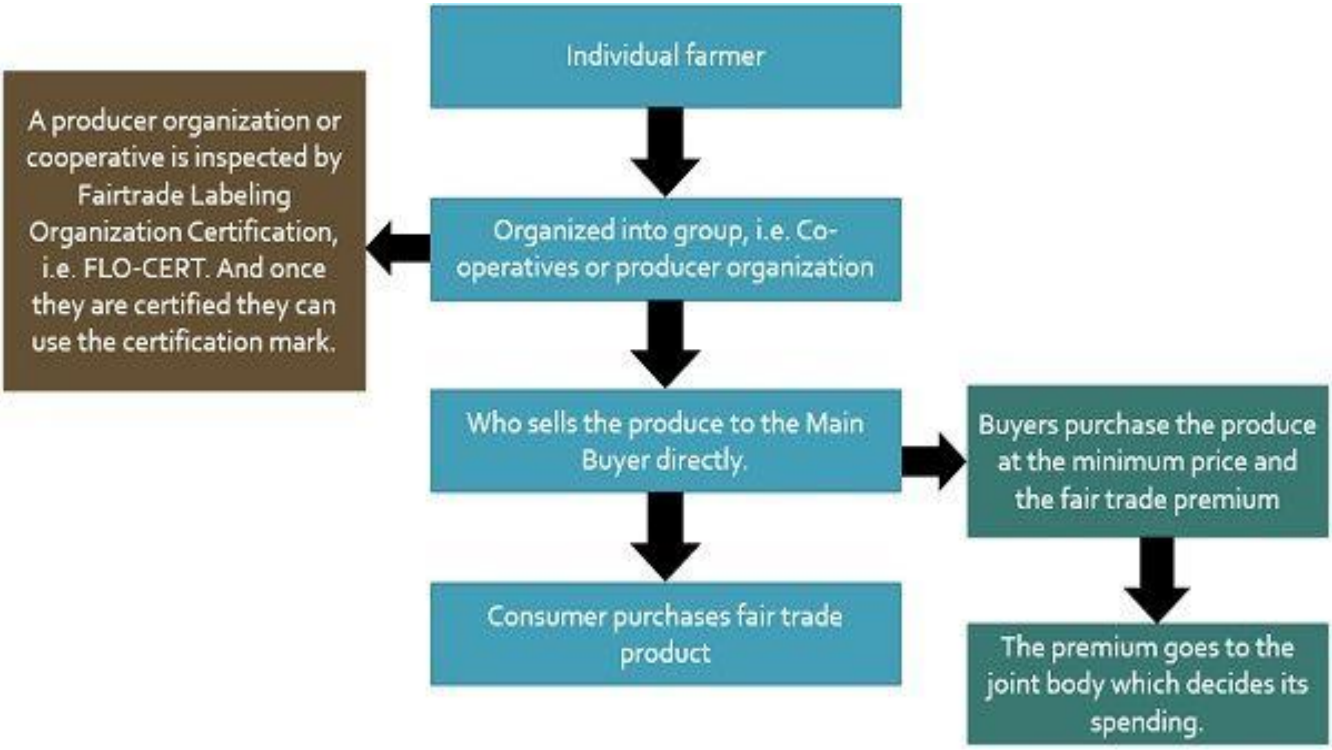
- It lays emphasis on lifting restrictions, import taxes, i.e. tariffs, subsidies on exports, trade regulations, embargoes, and other non-tariff barriers which are imposed on the exchange of goods and services to/from foreign countries.
- In other words, free trade refers to the full-fledged elimination of the trade barriers, to promote free movement of goods, services, labour and capital, globally. However, complete removal of barriers is theoretical, as practically government imposes certain measures to keep a check on imports and exports. Free Trade not just boost the efficiency of the international market but also helps in the economic growth of the participating countries. Typically, the participating countries enter into a bilateral agreement, which permits import and export of goods and services, without any restrictions.

Benefits of Free Trade

- Drives competitiveness
- Increases access to high-quality goods at reasonable prices
- Improves efficiency
- Supports innovation
- Promotes transparency and fairness

Fair Trade is mainly concerned with the impact of the trade on environment, labour standards and human rights overseas, so as to take steps to improve those effects.

- Fair Trade aims at minimizing exploitation in the trade market, as well as reducing human rights violations and violations to environmental rules. It also empowers the farmers, artisans and small producers to support themselves. And to do so, the rights of people belonging to marginalized groups are protected by way of fair wages and better working conditions, which contributes to sustainable development.
- Fair Trade helps the poor farmers, artisans and producers by providing fair and suitable price for their produce which covers the cost of production. It also allows them to get access to interest-free loans, or loans at the nominal interest rate. It ensures – fair prices, safe working conditions, conservation of natural resources and no enforced child labour.



	Free Trade	360° Fair Trade
Main goal	To increase nations' economic growth	To empower marginalized people and improve the quality of their lives
Focuses on	Trade policies between countries	Commerce among individuals and businesses
Major actions	Countries lower tariffs, quotas, and regulatory barriers to trade	Businesses work in partnership with artisans and farmers to ensure favorable financing, a living wage, and higher labor and environmental standards
Creates change through	Market and government policies	Living wage and community improvement costs
Primarily benefits	Corporations and businesses who export and import in participating countries	Small-scale farmers and artisans who lack economic and social opportunity
Supply Chain	Very complex with many levels between producers and consumers	Direct partnerships that take into account the needs of individual communities
Guided by	Trade policies and agreements, such as the Trans-Pacific Partnership	Fair Trade Principles www.fairtradefederation.org/principles

Protectionism

It is a policy of protecting the domestic businesses from foreign competition by applying tariffs, import quotas, or many types of other restrictions attached to the imports of foreign competitors' goods and services.

Protectionism

Pros	Cons
Protection of local firms from foreign competitors	Global welfare loss
Especially beneficial for the development of new products	Only temporary solution for problems
Development of local competitive advantage	Less pressure for innovations
Local job creation	Less price pressure
Trade deficits may decrease	Higher product prices
Additional tax revenue from import tariffs	Products may decline in quality
Higher profits for local companies	Problems for industries once protectionism is abandoned
Gap between the poor and the rich may close	Countries may lose connection to latest technological progress
Protectionism prevents unfair competitive advantages	Limited choice of products
Sense of patriotism	Knowledge cannot spread across borders
Less unlawful activities	Global technological progress may be slowed down
	Labor shortages in certain industries
	Freedom is important and should not be limited
	People may migrate to countries with free trade
	Market forces cannot work properly
	Protectionism may increase tensions between countries

Protectionist Policies

There are many protectionist policies in place in many nations despite the fact that there is a popular consensus that the world economy, as a whole, benefits from free trade.

- **Government-levied tariffs −** The best form of protectionist measure is the government-levied tariffs. The common practice is raising the price of the imported products so that they cost more and hence become less attractive than the domestic products. There are many believers that protectionism is a helpful policy for the emergent industries in the developing nations.

- **Import quotas −** Import quotas are the other forms of protectionism. These quotas limit the amount of products imported into a country. This is considered to be a more effective strategy than protective tariffs. Protective tariffs do not always repel the consumers who are ready to pay higher prices for imported goods.

- **Mercantilism −** Wars and recessions are the major reasons behind protectionism. On the other hand, peace and economic prosperity encourage free trade. In 17th and 18th centuries, the European monarchies used to rely heavily on protectionist policies. This was due to their aim to increase trade and improve the domestic economies. These (currently discredited) policies are called mercantilism.

- **Reciprocal trade agreements** − Reciprocal trade agreements limit the protectionist measures in lieu of eliminating them fully. However, protectionism still exists and is heard when economic hardships or joblessness is aggravated by foreign competition.

Currently, protectionism is in a unique form. Economists term the form as **administered protection**. Most rich nations have fair trade laws. The announced purpose of Free Trade Laws is twofold −

- First is to make sure that foreign countries do not subsidize exports so that market incentives are not distorted and hence efficient allocation of activity among the countries is not destroyed.
- The second purpose is to assure that international companies do not dump their exports in an aggressive manner.

These mechanisms are meant to augment free trade.

In the 18^{th} and 19^{th} century, almost all nations and nation-states believed that protectionism is a must for the well-being of domestic economies. However, with passing time, this idea started to change. The idea of liberalizations and thereby abolishment of protectionist measures peaked in the middle half of the 20th century. The epitome of liberalism took the first palpable shape as GATT, which was later replaced by the WTO.

Liberalization

It is the process of relaxation from government control. It is a very important economic term. Technically, it means the reductions in applied restrictions of the government on international trade and capital. Liberalization is also used in tandem with another term − Deregulation.

Deregulation is the disappearance of state restrictions on both domestic and international business. However, in principle, the two terms are distinct because liberalized markets are often subject to government regulations for various reasons, such as consumer protection. But in practice, both terms generally refer to the removal of state intervention in markets.

Advantages and disadvantages of free trade

Advantages of free trade

- Specialisation leading to increased output
- Trade allows economies of scale (larger market to sell to)
- Lower price and increased choice
- Competition and innovation

Disadvantages of free trade

- Risk – interdependence, over-reliance on trade, loss of control
- Unemployment (perhaps)
- Income inequality
- Environmental impact
- Culture

New Economic Policy (NEP)

- NEP refers to the economic liberalization or relaxation in the import tariff, deregulation of markets or opening the markets for private or foreign players and reduction of taxes to expand their economic wings of the country.
- Former PM Dr. Manmohan Singh is considered the Father of NEP in India.
- The thrust is to create a more competitive environment in the economy as a means to improving the productivity and efficiency of the system.

Liberalization, Privatization, and Globalization

Due to close resemblance and similar attributes, the term LPG (Liberalization, Privatization, and Globalization) is generally used nowadays to describe the phenomena of freeing up of markets.

Although the three terms are distinct and have their own attributes, it is particularly helpful to describe the contemporary and new market conditions of 21^{st} century through the term LPG. In fact, liberalization is the gateway to globalizations and hence, when we talk about the benefits of globalization, it is always a manifestation of the process of liberalization.

It is impossible to consider the business aspects without having a global view in many of the scenarios and hence, LPG is a way to deal with the latest marketing and operational trends in international marketing.

Promotion of global business

- International business development evolves through the normal processes of trade, foreign direct investment, capital flows, migration, and the advancement of technology in undeveloped nations.
- Huge growth opportunities created by the emerging middle class of nations such as Brazil, Russia, India, and China (the BRIC countries), many companies in the developed world are stepping in to provide goods and services to those countries.

Different Forms of International Business

Once the country has decided to go global it has to decide its mode of entry. The usual strategies are:

- Exporting

Strategies without FDI

- Licensing
- Franchising
- Contract Manufacturing
- Management Contract
- Turnkey Contract

Strategies with FDI

- Joint Venture
- Mergers & Acquisitions
- Direct Investment
- Fully owned subsidiaries
    - Strategic Alliance - Could be both with FDI or without FDI.

1. Exporting

- Exporting is a strategy in which the company exports a product from the home market to foreign market without any production or marketing base in the overseas market.
- Storing and processing is mainly done in the supplying firm's home country.
- Generally, the product remains the same as marketed in the home market.
- Most companies start their international expansion with exporting.
- When a firm receives canvassed items and exports them, it is called **Passive Export.** Alternately, if a strategic decision is taken to establish proper processes for organizing the export functions and for obtaining foreign sales, it is known as **Active Export**.
- **Forms of exporting**: It is usually of three types ;-

i) **Indirect exporting** – This is exporting the products to the host country either in the original form or in the modified form to a foreign country through another domestic company / export company or through any export agency.The organization sells produces their products to a third party who then sells it in a foreign market.E.g. An Export Mgmt Company (EMC) is a pvt. Company that acts as the export dept. for several manufacturers.

Advantages –

- Faster market access
- Concentration of production
- Little or no financial commitment
- No direct handling of export process.

Disadvantages –

- No control of distribution, sales, mktg etc.
- Higher risk as compared to direct exporting
- Inability to operate overseas

ii) **Direct Exporting** – Here the manufacturer is the exporter. A company directly sells its products in the host country's company through its distribution channels.The organization produces their products in the home market and then sells them to customers overseas.E.g. Tata Steel exports a large no. of steel pdts to USA, EU, Iraq, Afghanistan etc

Advantages - Control over foreign Markets, Good info from the mkt, Greater sales.

Disadvantages - Higher start-up costs, Time consuming

iii) **Cooperative Exporting** – This involves selling of products by a MNC to its affiliated company in the host country. This is of 2 typrs – Piggybacking and Countertrade.

Piggybacking

- Old form of strategic partnering.
- Useful when markets have high entry barriers.
- Produce good quality goods and find firms to carry them for you.
- Useful for companies with limited exporting activities, limited resources & lack of foreign market knowledge.
- E.g. A car company tying up with a tyre company

Countertrade

- Exchanging goods and services which are paid for in whole or part, with other goods & services, rather than money.
- E.g. Barter, switch trading , counter-purchase, buyback

- Countertrade is a system of international trading that helps governments reduce imbalances in trade between them and other countries.
- It involves the direct or indirect exchange of goods for other goods instead of currency.
- Countertrade is often used when a foreign currency is in short supply.
- It is a form if international trade in which payment of certain export and import transactions are mutually adjusted with each other, instead od monetary payments imports are paid by exports.
- The various forms of counter trade are barter system, buy back deal, compensation deal and counter purchase.
- Example - When PepsiCo wanted to enter the Indian market, the government stipulated that part of PepsiCo's local profits had to be used to purchase tomatoes. This requirement worked for PepsiCo, which also owned Pizza Hut and could export the tomatoes for overseas consumption.

Advantages:

i) Beneficial for developing and under-developed countries.

ii) It helps the firm to counter the problem of foreign exchange fluctuations.

iii) It helps firms to penetrate difficult markets

Disadvantages:

i) It has adverse effects on exports market development.

ii) It adversely affects competition.

Advantages of Exporting:

i) Increase in sales volume

ii) Low investment

iii) Less risks

Disadvantages of Exporting:

i) Unknown market

ii) No control over foreign market

iii) Lack of information about local environment

2. Licensing

- Licensing is a contractual transaction where the firm, the licensor, offers some proprietary assets to a foreign company, the license in exchange of some royalty fees.
- Licensor $\xrightarrow{\text{License}}$ Licensee
- Examples of assets that can be part of the licensing agreement include trademarks, technology, know-how, production processes and patents.
- Licensing also applies to intangible items like services.
- The licensor need not invest in any capital in the development of intellectual property, as its already developed by the licensor.
- Examples

Licensor	**Licensee**	
Disneyland	Oriental Land Company	Tokyo Disneyland
Kirkin brewery, largest beer producer of Japan	Molson	Canada
	Charles Well Brewery	UK
Chicago Mercantile Exchange	Nikkei Stock Index	Future markets

Advantages:

i) Less capital investment on the part of the licensor

ii) Low financial risk for the licensor

iii) It overcomes the problems of the Trade Barriers and high cost of transportation.

iv) Licensor can enter the foreign market without much effort.

v) The licensee need not invest any capital in the development of Intellectual Property.

vi) Licensee can take the advantage of the R&D of licensor.

Disadvantages:

i) Problem of leakage of the trade secrets of the licensor.

ii) There is scope of misunderstanding and disputes between the parties.

iii) Limited opportunities for both the parties involved.

iv) Both parties have to manage product quality and promotion.

3) Franchising

- It is similar to licensing.
- It is an arrangement whereby the franchisor gives the franchisee, the right to use the franchisor's trade names, trademarks, business models and / or know-how in given territory for a specific time period.
- In exchange the franchisor gets royalty payment.
- The franchisor provides the following payments to the franchisee.

i) Trademarks

ii) Operating Systems

iii) Product Regulations

iv) Support systems like advertising, employee training, reservation services etc.

- Examples –Food Companies in the U.S like McDonald's, Domino's Pizza. KFC

Advantages

i) The franchisee serves as the source of direact information for the franchisor about the host country's market, culture, customs, environment etc.

ii) Franchisor gets expert knowledge from the franchisee.

iii) There are no political risks involved.

iv) Since the franchisee's profits are directly tied to their efforts, franchisees are usually highly motivated.

v) Franchisee gets brand name and R&D at low cost.

Disadvantages

i) Franchisor doesn't have direct touch with the market and consumers.

ii) It is difficult to have full control over the franchisees.

iii) Possibility of leakage of trade secrets.

iv) Responsibilities of managing product quality and product promotion both.

4. Contract Manufacturing

- In this the company arranges with a local manufacturer to manufacture parts of the product or even the entire product.
- Marketing the products is the responsibility of the international firm.
- Here basically the international firm outsources the manufacturing and concentrates on marketing.
- Examples – Nat Steel Electronics (NEL) Singapore based and has facilities in Malaysia, Indonesia, China, Mexico. Apple, Compaq, IBM, HP

Advantages:

i) Significant cost saving can be achieved for labour intensive production processes by sourcing the product in a low wage country.

ii) MNCs provide impetus to small and medium scale industrial units engaged in production activities.

iii) Overcomes the risk of currency conversion.

Disadvantages:

i) Concerns of nurturing a future competitor.
ii) Since MNCs have less control over the manufacturing process, their goodwill may suffer if there is a problem in the product quality.
iii) Low labour cost countries usually have low labour productivity.
iv) This form is not suitable in case of high-tech products.

5. Management Contract

- Management contracts are agreements between investors or owners of a project, and a management company hired for coordinating and overseeing a contract.
- It spells out the conditions and duration of the agreement and the method of computing management fees.
- Here the companies have low level of technology and managerial expertise and therefor seek assistance from a foreign company.
- It is an agreement between two companies, in which one company provides managerial assistance, technical expertise and specialized services to the second company, till a certain period against some monetary compensation like fee,percentage over sales, performance bonus (based on profitability, sales growth, production and quality measures etc).
- Examples – Tata Tea. HarrsionMalayal and AVT have contracts to manage a large no. of tea plantations in Sri Lanka.

Advantages:

i) A foreign company gains additional monetary gain without any additional investment, risks and obligations.
ii) Management contract help the companies to enter in other business areas in the host country.
iii) The host company takes advantages of the transformation of skills and technology from the foreign firm which is not available locally.

Disadvantages

i) Lack of quality of products or carelessness of the host company can affect the prestige of the MNCs negatively.
ii) Chances of leakage of secrets of the MNCs technology.

iii) The host country always has the risk of being over dependent on the MNC thereby losing control.

6. Turnkey Contract

- A turnkey operation is a legal oath by the seller to supply a buyer with a facility fully equipped and ready to be operated by the buyer.
- A turnkey contract or project is an agreement under which a firm agrees to fully design, construct and fully equip a manufacturing business and turn the project over to a purchaser, when it is ready for operation against a monetary benefit.
- The monetary benefit can be pre-decided or it may be on percentage basis of the total cost incurred.
- Examples – Subway

Advantages:

i) Purchaser saves time and energy

ii) Assurance of quality implementation

iii) Lower cost due to economies of scale

Disadvantages:

i) Due to lack of long term interest of vendor, quality may suffer

ii) Purchaser may not have the know-how of how the plant works.

FDI Route

FDI – It is an investment in the form of a controlling ownership in a business in one country by an entity based in another country.

Sectors in which FDI is prohibited – Gambling & Betting, Lottery, Railways, Real estate, Manufacturing of tobacco, cigar etc.

Greenfield Investment – It refers to investment in a manufacturing et-up, offices or other physical company related structures or group of structures in an area where no previous facilities existed.E.g –McDonalds or Starbucks

Brownfield Investment – When a company purchases or leases an existing production facility to launch a new product activity.E.g. Tata Motor’s acquisition of Jaguar (already an existing factory in UK)

7. Mergers & Acquisitions

- When one company takes over another entity, and establishes itself as the new owner, the purchase is called an acquisition.
- From a legal point of view, the target company ceases to exist, the buyer absorbs the business, and the buyer's stock continues to be traded, while the target company’s stock ceases to trade.
- Example – Google acquiring Android and Disney acquiring Pixar.
- On the other hand, a merger describes two firms of approximately the same size, who join forces to move forward as a single new entity, rather than remain separately owned and operated. This action is known as a "merger of equals."
- Both companies' stocks are surrendered and new company stock is issued in its place.
- Example - Both Daimler-Benz and Chrysler ceased to exist when the two firms merged, and a new company, Daimler Chrysler, was created.

Advantages:

i) Easy and instant entry of a domestic firm into foreign market.
ii) Easy access to new technology or a patent right.
iii) Reduction in competition.
iv) Consolidation of image in theforeign market

Disadvantages:

i) At times the cost of acquisition is very high leading to financial burden on the domestic company.
ii) Lot of complexities involved in M&A.
iii) A lot of issues need to be sorted out by bankers, lawyers, financial consultants and M&A specialists.
iv) Lot of HR issues are likely to crop up.

8. Joint Venture

- When two or more firms join together to create a new business entity, it is called a joint venture.

- The uniqueness in a joint venture is its shared ownership.
- Various environmental factors like social, technological, economic and political environments may encourage joint ventures.
- Example – Vodafone and Telefonica, BMW and Toyota

Advantages:

i) JVs have greater capital return potential.

ii) JVs provide significant funds for major projects.

iii) JVs reduce the risks of international business as it is shared.

iv) The foreign firm doesn't face the hostility of the public and government as it partners with a local firm.

v) More control over operations.

Disadvantages:

i) Rise of conflict between the partners.

ii) Delay in decision making of a partner can lead to operational inefficiency.

iii) Slow decision making due to involvement of two or more decision makers.

9. Wholly Owned Subsidiaries

- A **wholly owned subsidiary** is a company that is completely owned by another company. The company that owns the subsidiary is called the **parent company** or **holding company**. The parent company will hold all of the subsidiary's common stock.
- Wholly owned subsidiaries may be part of the same industry as the parent company or part of an entirely different industry. Sometimes, a company will spin off part of itself as a wholly owned subsidiary, such as a computer company spinning off its printer manufacturing division.
- Companies that must rely upon suppliers and service providers can take control of their supply chain by use of wholly owned subsidiaries. This is a means of **vertical integration** where companies in a supply chain are under the control of a common owner. For example, a car manufacturing company may have several wholly owned subsidiaries, including a tire company and several different auto parts companies.

- Wholly owned subsidiaries also offer an opportunity for companies to diversify and manage risk.
- **Diversification** is a means for a company to reduce risk by developing different types of businesses so that if one business or industry isn't doing well, its other businesses may be able to pick up the slack and keep the company profitable. For example, a computer company may decide to get into the printer business, the television business, and the tablet business and either buy or form a wholly owned subsidiary for each new business. Damage from the failure of one subsidiary will not necessarily be fatal to the parent company.
- Similarly, a company can reduce its risk in entering into a new market or industry by using subsidiaries which help minimize the parent company's exposure. For example, if your company wants to enter into an emerging market that hasn't been established, it can form a subsidiary to enter the market leaving much of the risk of loss on the subsidiary's shoulders.
- A company may also create or purchase wholly owned subsidiaries when conducting business abroad. Sometimes, a parent company will create a subsidiary in a foreign country because it will receive favourable tax treatment from the foreign government. Alternatively, a parent company may be required to form a local subsidiary in order to conduct business in the country. The subsidiary may even have to be formed with a local business partner.

Example - Volkswagen AG, which wholly owns Volkswagen Group of America, Inc. and its distinguished brands: Audi, Bentley, Bugatti, Lamborghini (wholly owned by Audi AG), and Volkswagen.

In addition, Marvel Entertainment and EDL Holding Company LLC are wholly owned subsidiaries of The Walt Disney Company. Coffee giant Starbucks Japan is a wholly owned subsidiary of Starbucks Corp.

Advantages:

i) All the profits go directly to the company.

ii) It allows the enterprise to manage and control its own processes, marketing, production and sourcing decisions.

iii) Shows a commitment to the local market.

Disadvantages:

i) There are a number of risks associated with this.

ii) Complete ownership means that he parent company will have to bear the full burden of possible losses.

iii) Developing a foreign presence without the support of a local partner is very difficult.

10. Assembly Operation

- It is related to heavy and complex technological goods like automobile goods, electrical goods etc.
- Manufacturing is done in home country or where resources are richly available and assembling of goods is done in the target country or in nearby country.
- It is not possible to export fully assembled goods due to its nature hence goods are exported in parts and assembled in another country.

Advantages:

i) Assembly operations are labour intensive so best suited for highly populated countries.

ii) Generates employment in host country.

iii) Minimum political risk.

iv) Investment made in foreign country is lesser as compared to setting up manufacturing establishments.

Disadvantages:

i) Sometimes the quality may be affected spoiling the brand name.
ii) Difficulty in tracking technical fault.

11. Strategic Alliance

- It is a cooperative agreement between two or more companies to work together & share resources to achieve a common business objective.
- E.g. – ICICI Bank & Vodafone India launched a money transfer & payment service called as ‘m-pesa’.

Advantages

- Technology exchange
- Global Competition

- Industry Convergence
- Economies of Scale & reduction of risk

Disadvantages

- Clashing cultures & management styles
- Legal problems
- Damage to reputation

Ethical Issues in International Business

Ethics refers to accepted principles of right or wrong that govern the conduct of a person, the members of a profession, or the actions of an organization.As political, legal, economic, and cultural norms vary from nation to nation, various ethical issues rise with them. A normal practice may be ethical in one country but unethical in another.Multinational managers need to be sensitive to these varying differences and able to choose an ethical action accordingly.In an international business, the most important ethical issues involve:

i) Employment Practices

ii) Human Rights

iii) Environmental Norms

iv) Corruption

v) Moral obligation of international corporations.

i) **Employment Practices**

Ethical issues may be related to employment practices in many nations. The conditions in a host country may be much inferior to those in a multinational's home nation. Many may suggest that pay and work conditions need to be similar across nations, but no one actually cares about the quantum of this divergence.When work conditions in a host nation are clearly inferior to those in a multinational's home nation, what standards should be applied—those of the home nation, those of the host nation, or something in between? Examples: Apple iPodin China; Nike in Vietnam; Levi Strauss and Tan family China. 12-hour workdays, minimal pay, and indifference in protecting workers from toxic chemicals are common in some developing nations. Is it fine for a multinational to fall prey to the same practice when they chose such developing nations as their host countries? The answers to these questions may seem to be easy, but in practice, they really create huge dilemmas.In these cases, it is advisable to establish minimal acceptable working standards and audit foreign subsidiaries and subcontractors on a regular basis.

ii) **Human Rights**

Rights that we take for granted in developed nations, such as freedom of association, freedom of speech, freedom of assembly, freedom of movement, freedom from political repression, and so on, are by no means universally accepted.

Examples: South Africa until 1994; China's human rights record; Myanmar (formally known as Burma); Royal Dutch Shell in Nigeria.

What is the responsibility of an MNC when operating in a country where basic human rights are violated? Should the company be there at all?

iii) **Environmental Pollution**

When environmental regulation in the host nation is much inferior to those in the home nation, ethical issues may arise. Many nations have firm regulations regarding the emission of pollutants, the dumping and use of toxic materials, and so on. Developing nations may not be so strict, and according to critics, it results in much increased levels of pollution from the operations of multinationals in host nations.

Is it fine for multinational firms to pollute the developing host nations? What is the appropriate and morally correct thing to do in such circumstances? Should MNCs be allowed to pollute the host countries for their economic advantage, or the MNCs should make sure that foreign subsidiaries follow the same standards as set in their home countries? These issues are not old; they are still very much contemporary.

Examples: foreign oil companies in Nigeria; Coca Cola plant in Kerala

iv) Corruption

Corruption is an issue in every society in history, and it continues to be so even today. Corrupt government officials are everywhere. International businesses often seem to gain and have gained financial and business advantages by bribing those officials, which is clearly unethical.

Examples: Bofors case; Enron; Lockheed case in US.

Corruption in Japan- In the 1970s, Carl Kotchian, an American business executive who served as the president of **Lockheed Corporation**, paid $12.5 million to Japanese agents and government officials to sell Lockheed's TriStar jet to **All Nippon Airways**. After the case was discovered, U.S. officials charged Lockheed with falsification of its records and tax violations.

The revelations created a scandal in Japan as well. The ministers who took the bribe were charged, and one committed suicide. It even led to the jailing of Japan's prime minister. The Japanese government fell in disgrace, and the Japanese citizens were outraged. Kotchian had, without doubt, engaged in unethical behaviour.

v) Moral Obligations

Some of the modern philosophers argue that the power of MNCs brings with it the social responsibility to give resources back to the societies. The idea of Social Responsibility arises due to the philosophy that businesspeople should consider the social consequences of their actions.They should also care that decisions should have both meaningful and ethical economic and social consequences. Social responsibility can be supported because it is the correct and appropriate way for a business to behave. Businesses, particularly the large and very successful ones, need to recognize their social and moral obligations and give resources and donations back to the societies.

Example: BP, company policy to undertake "social investments" in the countries where it does business

Ethical Dilemmas

They are situations in which none of the available alternatives seems ethically acceptable.

Theories of Ethical Standards

1. **The Utilitarian Approach**

- Some ethicists emphasize that the ethical action is the one that provides the most good or does the least harm, or, to put it another way, produces the greatest balance of good over harm.
- The ethical corporate action, then, is the one that produces the greatest good and does the least harm for all who are affected -- customers, employees, shareholders, the community, and the environment.
- Ethical warfare balances the good achieved in ending terrorism with the harm done to all parties through death, injuries, and destruction.
- The utilitarian approach deals with consequences; it tries both to increase the good done and to reduce the harm done.

2. **The Rights Approach**

- Other philosophers and ethicists suggest that the ethical action is the one that best protects and respects the moral rights of those affected.
- This approach starts from the belief that humans have a dignity based on their human nature per se or on their ability to choose freely what they do with their lives.
- On the basis of such dignity, they have a right to be treated as ends and not merely as means to other ends.
- The list of moral rights -- including the rights to make one's own choices about what kind of life to lead, to be told the truth, not to be injured, to a degree of privacy, and so on -- is widely debated; some now argue that non-humans have rights, too.
- Also, it is often said that rights imply duties -- in particular, the duty to respect others' rights.

3. **The Fairness or Justice Approach**

- Aristotle and other Greek philosophers have contributed the idea that all equals should be treated equally.

- Today we use this idea to say that ethical actions treat all human beings equally-or if unequally, then fairly based on some standard that is defensible.

- We pay people more based on their harder work or the greater amount that they contribute to an organization,and say that is fair.

- But there is a debate over CEO salaries that are hundreds of times larger than the pay of others; many ask whether the huge disparity is based on a defensible standard or whether it is the result of an imbalance of power and hence is unfair.

4. **The Common Good Approach**

- The Greek philosophers have also contributed the notion that life in community is a good in itself and our actions should contribute to that life.

- This approach suggests that the interlocking relationships of society are the basis of ethical reasoning and that respect and compassion for all others -- especially the vulnerable -- are requirements of such reasoning.

- This approach also calls attention to the common conditions that are important to the welfare of everyone.

- This may be a system of laws, effective police and fire departments, health care, a public educational system, or even public recreational areas.

5. **The Virtue Approach**

- A very ancient approach to ethics is that ethical actions ought to be consistent with certain ideal virtues that provide for the full development of our humanity.

- These virtues are dispositions and habits that enable us to act according to the highest potential of our character and on behalf of values like truth and beauty.

- Honesty, courage, compassion, generosity, tolerance, love, fidelity, integrity, fairness, self-control, and prudence are all examples of virtues.

- Virtue ethics asks of any action, "What kind of person will I become if I do this?" or "Is this action consistent with my acting at my best?"

Determinants of Ethical Behaviour

1. **Personal Ethics** - Personal ethical code exerts a profound influence on business ethics. An individual with a strong sense of personal ethics is less likely to behave in an unethical manner in a business setting. Personal ethics comes from sources like our parents, our schools, our religion, and the media.

2. **Decision-making Process** - People simply forget that business decisions may also have an important ethical dimension. Most often ethical considerations are not incorporated into business decision making. Example: Pfizer's Drug Testing Strategy in Nigeria; Nike's subcontracting decision.

3. **Organizational Culture** - Business climate sometimes do not encourage people to think through the ethical consequences of business decisions • All decisions are purely economic in nature (profit maximization) – Example: Case of former Enron CEO Kenneth Lay.

4. **Unrealistic Performance Expectations** - Pressure from the parent company to meet unrealistic performance goals that can be attained only by cutting corners or acting in an unethical manner. This creates a pressure-cooker culture – Example: Lesson from the Enron debacle. Conversely, an organization culture can do just the opposite and reinforce the need for ethical behavior – Example: Hewlett-Packard (The HP way).

5. **Leadership** - Leaders help to establish the culture of an organization, and they set the example that others follow – Example: Enron and Hewlett- Packard.

Approaches to Business Ethics

The four commonly discussed approaches to business ethics are:

1. The Friedman doctrine

- By the Nobel laurite Milton Friedman in1970
- Friedman's basic position is that the only social responsibility of business is to increase profits, so long as the company stays within the rules of law.
- He rejects the idea that businesses should undertake social expenditures beyond those mandated by the law and required for the efficient running of a business

- But, is it social responsibility a synonym for business ethics? There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say that it engages in open and free competition without deception or fraud.

2. **Cultural relativism**

- All ethics are culturally determined - ethics are nothing more than the reflection of a culture.

- Accordingly, a firm should adopt the ethics of the culture in which it is operating – If a culture supports slavery, is it OK to use slave labour in a country?

- In some countries, payment of bribes to government officials is necessary to get business done, and if not ethically desirable, it is at least ethically acceptable. “When in Rome do as the Romans do”.

3. **The Righteous Moralist**

- MNC’s home-country standards of ethics are the appropriate ones for companies to follow in foreign countries.

- Examples: American bank manager in Italy – U.S. laws set down strict guidelines regarding minimum wage and working Conditions.

- Should US MNCs apply the same in a foreign country? It will nullify the reason for investing in that country?

4. **The Naive Immoralist**

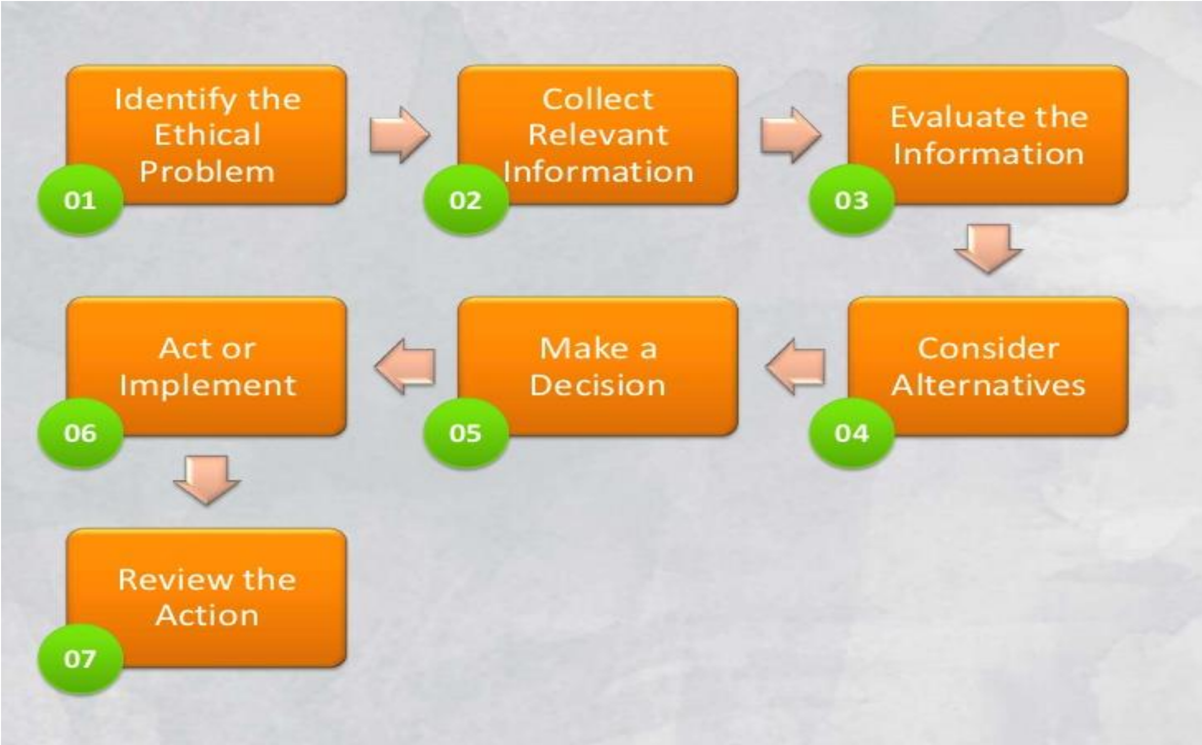
- If firms from other nations are not following ethical norms in a host nation, then we should not either.

- Examples: Drug lord problem; Child labour issues

- Objections to this view: – An action is not always ethically justified if everyone is doing it – MNCs do have the ability to change the prevailing practice in a country. It can use its power for a positive moral purpose

- Example: BP’s zero-tolerance policy to bribes

Ethical Decision Making



1. **Identify the Ethical Problem** – The decision maker must be able to determine if there is a possible violation of an important ethical principle, societal law, or organizational standard or policy.

2. **Collect Relevant Information -** The decision maker should seek to gather as much information as possible about which rights are being forsaken and to what degree.A focused research will help the decision maker to measure the type, degree, and amount of harm being inflicted or that will be inflicted on others.

3. **Evaluate the Information** - Once the information has been collected, the decision maker must apply some type of standard or assessment criterion to evaluate the situation.

4. **Consider Alternative** - The decision maker needs to generate a set of possible action alternatives, such as: confronting another person's actions, seeking a higher authority, or stepping in and changing the direction of what is happening.

5. **Make a Decision** - A decision maker selects a course of action that is supported by all the ethics theories or other evaluation criteria used in the decision-making process.

6. **Act or Implement** - Once the action alternatives have been identified in Step 4 and the optimal response is selected in Step 5, the action is taken in Step 6.

7. **Review the Action** - Once the action has been taken and the results are known, the decision maker should review the consequences of the action. If the optimal resolution to the problem is not achieved, the decision maker may need to modify the actions being taken or return to the beginning of the decision-making process.

PLUSDecision Making Model

Theletters in PLUS each stand for a filter that leaders can use for decision-making:

- **P – Policies and Procedures:**
  Is the decision in line with the policies laid out by the company?
- **L – Legal:**
  Will this violate any legal parameters or regulations?
- **U – Universal:**
  How does this relate to the values and principles established for the organization to operate? Is it in tune with core values and the company culture?
- **S – Self:**
  Does it meet my standards of fairness and justice? This particular lens fits well with the virtue approach that is a part of the five common standards mentioned above.

How do managers decide upon an ethical course of action when confronted with decisions pertaining to working conditions, human rights, corruption, and environmental pollution? Five things that an international business and its managers can do to make sure ethical issues are considered in business decisions.These are :

1) Favour hiring and promoting people with a well- grounded sense of personal ethics.

2) Build a culture that places a high value on ethical behaviour.

3) Make sure that leaders within the business not only articulate the rhetoric of ethical behaviour, but also act in a manner that is consistent with that rhetoric.

4) Implement decision-making processes that require people to consider the ethical dimension of business decisions.

5) Develop moral courage.

General Agreements on Tariffs and Trade (GATT)

As a part of the economic recovery after World War II, Bretton Woods Conference suggested an organization to regulate trade wherein an idea to form International Trade Organization (ITO) was formed. GATT was negotiated during the UN Conference on Trade and Employment and was the outcome of the failure of negotiating governments to create the International Trade Organization (ITO). GATT was formed in 1947 and transformed to World Trade Organization (WTO) in 1995.

The General Agreement on Tariffs and Trade (GATT) is a multilateral agreement regulating international trade. According to its preamble, its purpose is the "substantial reduction of tariffs and other trade barriers and the elimination of preferences, on a reciprocal and mutually advantageous basis."

On 1 January, 1948 the agreement was signed by 23 countries: Australia, Belgium, Brazil, Burma, Canada, Ceylon, Chile, Chi na, Cuba, the Czechoslovak Republic, France, India, Lebanon, Luxembourg, Netherlands, New Zealand, Norway, Pakistan, Southern Rhodesia, Syria, South Africa, the United Kingdom, and the United States.GATT held a total of eight rounds, during which countries exchanged tariff concessions and reduced tariffs.According to GATTs own estimates, the negotiations created 123 agreements that covered 45,000 tariff items that related to approximately one-half of world trade or $10 billion in trade.

The term **multilateral trade negotiations** (MTN) initially applied to negotiations betweenGATT member nations conducted under the auspices of the GATT and aimed at reducing tariff and nontariff trade barriers.

In 1995 the WTO replaced the GATT as the administrative body. A current round of multilateral trade negotiations was conducted in the Doha Development Agenda round.

Prior to the ongoing Doha Development Round, eight GATT sessions took place:

- 1st Round: Geneva Round, 1947
- 2nd Round: Annecy Round, 1949
- 3rd Round: Torquay Round, 1950-51
- 4th Round: Geneva Round, 1955-56
- 5th Round: Dillon Round, 1960-61
- 6th Round: Kennedy Round, 1963-67
- 7th Round: Tokyo Round, 1973-79
- 8th Round: Uruguay Round, 1986-94

GATT TRADE ROUNDS

Year	Place / Name	Subjects Covered	Countries
1947	Geneva	Tariffs	23
1949	Annecy	Tariffs	13
1951	Torquay	Tariffs	38
1956	Geneva	Tariffs	26
1960 – 1961	Dillon Round (Geneva)	Tariffs	26
1964 – 1967	Kennedy Round (Tokyo)	Tariffs and Anti-Dumping Measures	62
1973 – 1979	Tokyo Round	Tariffs, Non-tariff Measures, Framework Agreements	102
1986 – 1994	Uruguay Round	Tariffs, Non-tariff Measures, Rules, Services, Intellectual Property, Dispute Settlement, Textiles, Agriculture, Creation of WTO	123
2001-2013	Doha	Tariffs, non-tariff measures,	159

GATTs main objective:

- Reduction of barriers to international trade
- Achieved through reduction of tariff barriers, quantitative restrictions and subsidies on trade through a series of agreements

Terms which helpunderstanding GATT

A) **TRADE BARRIERS**: These are Tariff and Non-Tariff Barriers. While free-trade maximizes world welfare, most nations impose some trade restrictions that benefit special groups in the nation.

i) **Tariff Barriers**

• The most important type of trade restriction historically is the tariff.This is a tax or duty on the imports or exports. When a small nation imposes an import tariff, the domestic price of the importable commodity rises by the full amount of the tariff for individuals in nation. As a result, domestic production of the importable commodity expands while domestic consumption and imports fall. However, the nation as a whole faces the unchanged world price since the nation itself collects the tariff.

- An import tariff is a duty on the imported commodity, while an export tariff is a duty on the exported commodity.Export tariffs are prohibited by the U.S. Constitution but are often applied by developing countries on their traditional exports (such as Ghana on it's cocoa and Brazil on it's coffee) to get better prices and revenues. Developing nations rely heavy on export tariff to raise revenues because of their ease of collection.On the other hand, industrial countries invariably impose tariffs or other trade restrictions to protect some(usually labor-intensive)industry, while using mostly income taxes to raise revenues.

ii) Non-Tariff Barriers

- International trade also hampered by numerous technical, administrative and other regulations. These include safety regulations for automobile and electrical equipment, health regulations for the hygienic production and packaging of imported food products, and labelling requirements showing origin and contents. National government sometimes grant subsidies to domestic producers to help improve their trade position. Such devices are indirect form of protection provided to domestic businesses, whether they may be import competing producers or exporters.
- Subsidies - Two types of subsidies can be distinguished: a domestic subsidy, which is sometimes granted to producers of import-competing goods,and an export subsidy, which goes to producers of goods that are to be sold overseas.
- Government Procurement Policies: Because government agencies are large buyers of goods and services, they are attractive customers for foreign suppliers. Most governments however, favour domestic suppliers over foreign ones in the procurement materials and products. E.g, Government often extend preferences to domestic suppliers in the form of buy-national policies campaigns.

B) Trade Related Aspects of Intellectual Property Rights (TRIPS) – These include copyright protection, trademarks, trade secrets, industrial design, integrated circuits, geographical indications (GI) and patents.

C) Trade Related Investment Measures (TRIMS) – This Agreement, negotiated during the Uruguay Round, applies only to measures that affect trade in goods. Recognizing that certain investment measures can have trade-restrictive and distorting effects, it states that no Member shall apply a measure that is prohibited by the provisions of GATT.

Major Provisions of GATT

- GATT's major principle was **trade without discrimination**. The participating nations opened the markets impartially to every other member. According to GATT, once a nation and its largest trade allies had agreed to reduce a tariff, that reduction automatically became applicable to all other GATT members.
- GATT preferred **protection through tariffs** and by leveraging on it, GATT systematically tried to eliminate the import quotas or other quantitative trade restrictions.
- GATT also had **homogenous customs regulations** and the obligation of the participating nations in negotiating for tariff reductions on any other nation's request.
- The **escape clause** was also in place for contracting nations to modify the agreements when their domestic producers suffered excessive losses due to the trade concessions.
- There are **Special provisions to promote the trade of developing countries.**

Role of GATT in Promoting International Trade

GATT's role was instrumental in the following aspects −

- GATT formulated standards to direct the contracting nations to take part in international trade. As mentioned above, GATT stipulated some basic principles for the contracting parties.
- GATT cut tariffs for the mutual benefit of an accelerated trade liberalization. There was a palpable reduction, about 35% on average, in both Kennedy and Tokyo Rounds.

- GATT brought discrimination in tariff down to promote reducing other trade barriers. GATT had regulated that the participating nations cannot increase tariffs at will.

- GATT, in its progressive days, tried to protect the desires of the developing countries in terms of international trade. It established some special measures, including the tariff protection for select industries. GATT made sure that the developing countries got a preferential treatment.
- Finally, GATT was the "court of international trade." Settling the disputes between two or more parties was one of its primary objectives. GATT had become a legal guardian of nations for settling trade disputes.

Uruguay Round - Started in 1986

The main objectives of the Uruguay Round were:

1. To reduce agricultural subsidies
2. To lift restrictions on foreign investment
3. To begin the process of opening trade in services like banking and insurance.
4. To include the protection of intellectual property.

Dunkel Draft

Arthur Dunkel was the Director-General of the GATT during 1980-1993. He prepared a document called "Dunkel Draft" which put together the results of negotiations and provided an arbitrated solution to issues on which negotiators failed to agree. Even though the United States and India continued to bargain for changes to the Dunkel Draft, only minor amendments were made in the sphere of agriculture. The Dunkel Draft was accepted and became the foundation of the World Trade organization.

Multilateral Trade Negotiations and Agreements

Multilateral Trade Agreements are commerce treaties among three or more nations. The agreements reduce tariffs and make it easier for businesses to import and export. Since they are among many countries, they are difficult to negotiate.

Advantages:

- Multilateral agreements make all signatories treat each other equally. No country can give better trade deals to one country than it does to another. That levels the playing field. It's especially critical for emerging market countries. Many of them are smaller in size, making them less competitive. The Most Favoured Nation confers the best trading terms a nation can get from a trading partner. Developing countries benefit the most from this trading status.
- The second benefit is that it increases trade for every participant. Their companies enjoy low tariffs. That makes their exports cheaper.
- The third benefit is it standardizes commerce regulations for all the trade partners. Companies save legal costs since they follow the same rules for each country.
- The fourth benefit is that countries can negotiate trade deals with more than one country at a time. Trade agreements undergo a detailed approval process. Most countries would prefer to get one agreement ratified covering many countries at once.
- The fifth benefit applies to emerging markets. Bilateral trade agreements tend to favor the country with the best economy. That puts the weaker nation at a disadvantage. But making emerging markets stronger helps the developed economy over time.

Successes of GATT

- Increased world trade growth 1950s and 1960s — around 8% a year on average.
- With Trade growth, production growth was also witnessed.
- Recognition of multilateral trading system as the anchor for development and an instrument of economic and trade reform.

Problems of GATT

1. Slow Dispute Settlement mechanism

2. Formation of Regional Blocks

3. Most develop countries took their own Commitments Non-Seriously

4. Negotiation Tactics

5. Un-necessarily pressuring Under-developed Countries

Reasons behind the Formation of WTO

On 1st January, 1995, the World Trade Organization replaced GATT. The reasons for GATT being replaced by the WTO are the following.

- GATT was only a provisional arrangement. It lacked the qualities of an international covenant, and it could not ensure the enforcement mechanisms. GATT could do nothing in case of a bilateral trade-agreement failure. There were rules set for enforcement by GATT, but there was no mechanism for its application.

- GATT's jurisdiction was applicable only to product-transactions. Due to globalization, services and technologies became a major part of international investments and trade.

- Limitations and restriction on dispute settlement systems of GATT also made it vulnerable to challenges. GATT required a fully positive consensus in the GATT Council to propose the dispute to the panel. Many countries often objected in dispute settlement cases related to discrimination.

- Moreover, GATT's rules were not sufficiently strict and their execution was very hard to practice. Many participating parties tried to bend the rules of GATT in their self-interests, and GATT could not verify and inspect these issues.

- Finally, there were some influences of powerful nations in some historical multilateral rounds. Starting from the Geneva Round till the Uruguay Round, national sovereignty was present in the multilateral negotiation rounds.

The WTO was a natural demand of the times for a holistic development of economies.

ThesefFactors convinced GATT members that a new effort to reinforce and extend the multilateral system should be attempted. That effort resulted in the Uruguay Round, the Marrakesh Declaration, and the creation of the WTO.

The World Trade Organization (WTO) is the single global international organization dealing with the rules related to international trade. WTO's agreements are negotiated and signed by a majority of prominent trading nations. The agreements are ratified in the parliaments of the contracting countries.

Objectives of WTO

The WTO reiterates the objectives of GATT

1. Promote trade flows by encouraging nations to adopt non-discriminatory and predictable trade policies.

2. Raising standard of living and incomes, promoting full employment, expanding production and trade and optimum utilization of world's resources.

3. Introduce sustainable development-a concept which envisages that development..

4. Taking positive steps to ensure that developing countries, especially the least developed ones, secure a better share of growth in world trade

5. Establish procedures for resolving trade disputes among members.

Ministerial Conferences

It is the topmost decision-making body of the WTO, which usually meets every two years. It brings together all members of the WTO, all of which are countries or customs unions. The Ministerial Conference can take decisions on all matters under any of the multilateral trade agreements.

The 1st Ministerial Conference was held in Singapore in 1996 in which there was a lot of disagreements between developed and developing nations over four issues – transparency of govt. procurements, trade facilitation, trade investments and trade competition. This was followed by a second ministerial conference in Geneva. The third conference in Seattle ended in failure with huge demonstrations. The fourth ministerial conference was held at Doha, in Qatar in 2001 and is popularly called the Doha Round.

Doha Round

• Launched at the fourth ministerial conference in Doha, Qatar in November 2001.

• Succeeded the Uruguay round and the three ministerial conferences at Singapore (1996), Geneva (1998) and Seattle (1999).

Objectives:

• Lower trade barriers around the world.

• Committing all countries to negotiations opening agricultural and manufacturing markets, as well as trade-in-services (GATS) negotiations and expanded intellectual property regulation (TRIPS).

• Make trade rules fairer for developing countries

Key Issues at Doha

•Agriculture has become the linchpin of the agenda for both developing and developed countries.

• Compulsory licensing of medicines and patent protection.

• A review of provisions giving special and differential treatment to developing countries.

• Resolve problems that developing countries are having in implementing current trade obligations.

• Key Interests for ASEAN countries –

- Greater market access for industrial goods
- Trade facilitation
- Anti-dumping and subsidies
- Technical Co-operation
- Effective dispute settlement mechanism

Ministerial Declaration

• The Doha Ministerial Declaration mandate for agriculture calls for comprehensive negotiations aimed at substantial improvements in market access, reduction of export subsidies.

- The Declaration also provides that special and different treatment for developing countries would be an integral part of all parts of negotiations.

- The Declaration took note of non-trade concerns reflected in negotiations proposal of various member countries and confirmed that they would be taken in to account in negotiations.

Intellectual Property Declaration

- The Doha Declaration on public health sought to alleviate developing countries dissatisfaction with aspects of the TRIPS regime.

- The declaration committed member states to interpret and implement the agreement to support public health and to promote access to medicines for all. Intellectual property declaration.

Agriculture Issues in Developing Nations

• One of the key issues is the Agreement on Agriculture (AoA).

• Areas related to Agriculture-Market Access, Domestic Support, export Competition, Trade Related Intellectual Property Rights.

• 40 to 50 % of support to the farmers in the form of Green Box subsidies.

• Developed countries allowed to retain 80% of their subsidies while developing countries can subsidize their farmers not more than 10%.

• Increasing dependency on imports for food grains could bring strain on external payment position of these countries

Functions of WTO

• Administering WTO trade agreements

• Forum for trade negotiations

• Handling trade disputes

• Monitoring national trade policies

• Technical assistance and training for developing countries

• Cooperation with other international organizations

The Principles of WTO

1. Non-discrimination For eg. India is trading with many countries by imposing some tariffs on import or export, but acc. to WTO we cannot impose high tariffs on one trading nation and low tariffs on another. We have to treat them equally.

2. Transparency For eg. India changed its policies regarding direct foreign investment. So Indian Government released a press note for other countries regarding its policy change. Press note came in effect from May 12, 2015.

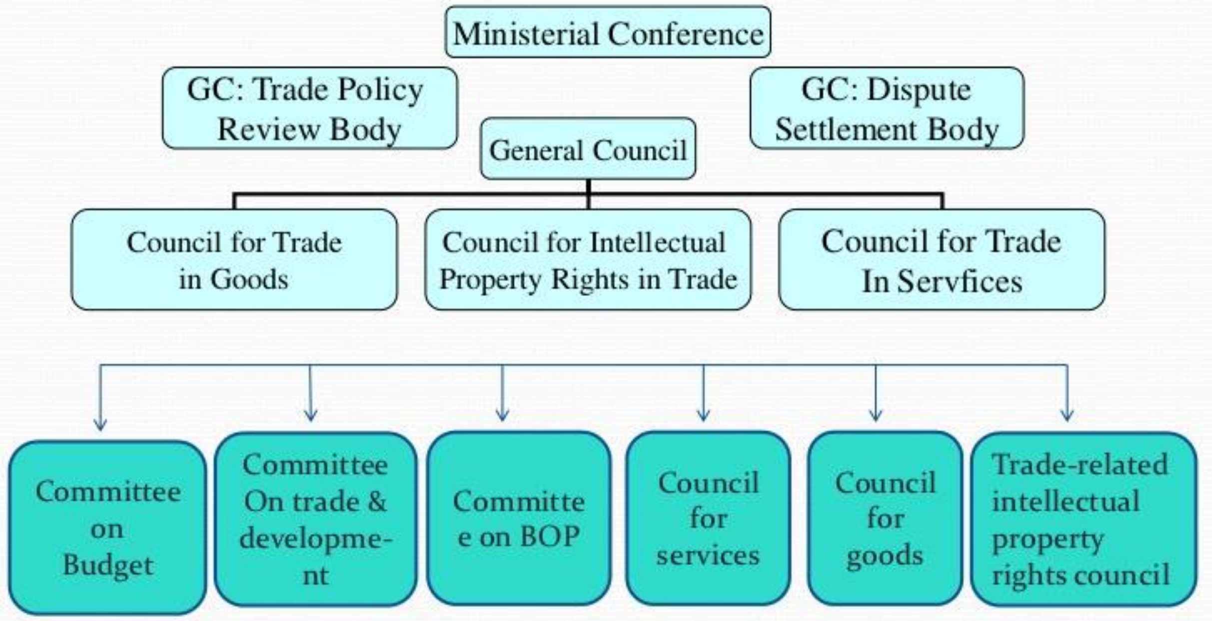
3. Binding Commitments For eg. India is doing free trade with Sri Lanka (1998) and Thailand (2003) , having trade agreements with Bangladesh, Bhutan, Maldives, Japan, South Korea, Mongolia etc

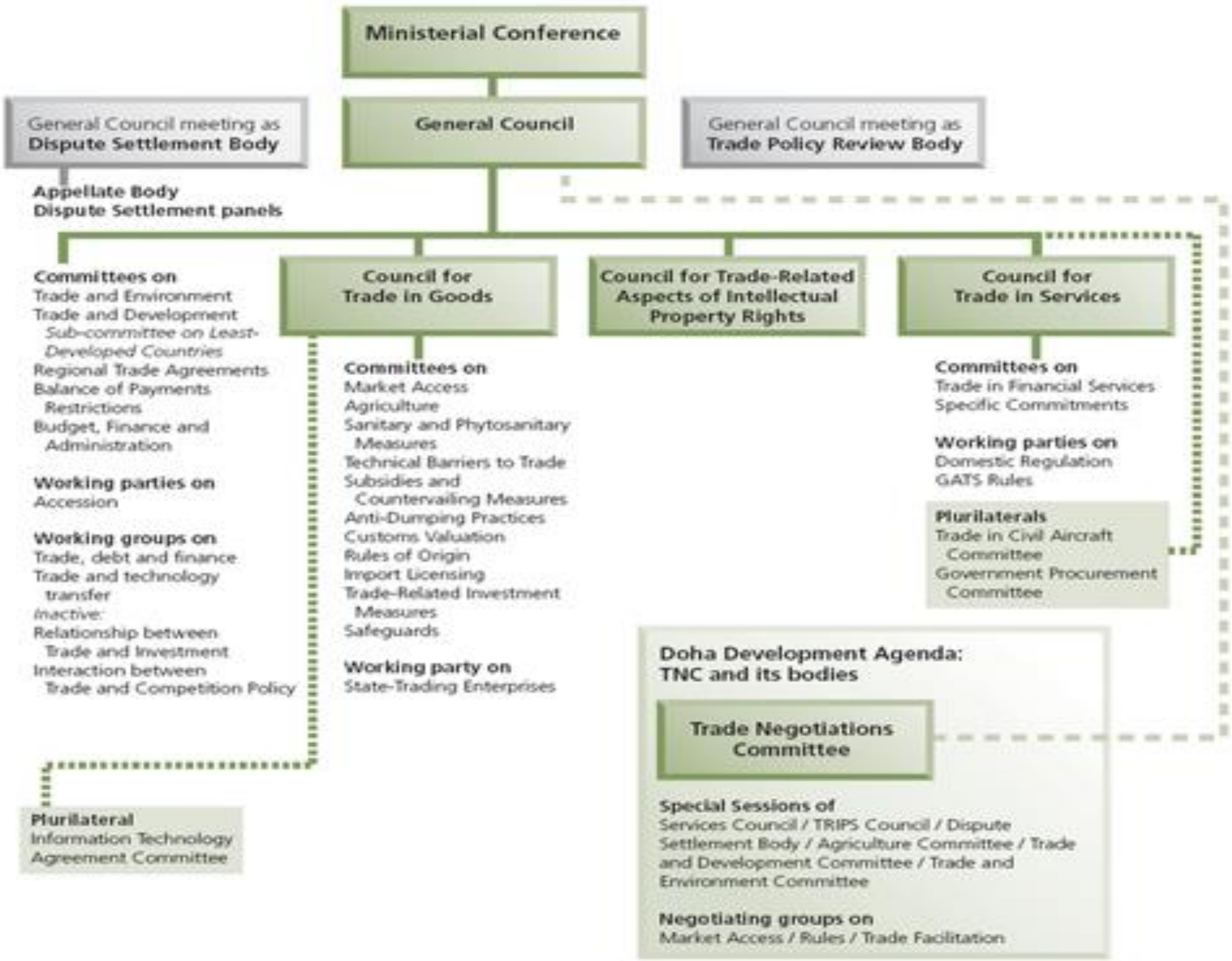
4. Reciprocity for eg. In case of Russia–USA and Iran- UNO, trade sanctions was imposed on Russia and Iran prohibiting them to do trade with other countries.

5. Safety valve for eg. India imposes sanctions on import of tyres from China as it threatens the domestic tyre manufacturing companies’ sales.

Organizational Structure of WTO

ORGNISATIONAL STRUCTURE





In WTO the highest authority is responsible to conduct ministerial conference. It occurs generally two or three times in a year. The next level are three General Councils:

i) The General Council

ii) The General Council : The Dispute Settlement Body

iii) The General Council : Trade Policy Review Body

The General Council is further divided into

1. **Council for Trade in Goods**– There are 11 committees under the jurisdiction of the Goods Council, each of which has a specific task. All members of the WTO participate in the committees.

2. **Council for Trade in Services**– This operates under the guidance of the General Council and is responsible for keeping an eye over the functioning of the General Agreements on Trades in Services (GATS). It is open to all WTO members.

3. **Council for Trade-Related Aspects of Intellectual Property Rights**– The Council keeps information on intellectual property in the WTO, news and official records of the activities of the TRIPS Council, and details of the WTO's works with other international organizations in the field.

4. **Trade Negotiation Committees** – The TNC is the committee which deal with current trade talk round in various subjects like agriculture, market access, subsidies, anti-dumping measures and so on.

Trade Without Discrimination

1. **Most – favoured nation (MFN)** – treating other people equally – This principle means that every time a member country reduces its trade barrier to open up a market, this has to be done for the same goods and services from all its trading partners. It is not allowed to discriminate between trading partners.

2. **National treatment** – Treating foreigners and locals equally – Locally produced goods and imported goods should be treated equally. This treatment should apply in case of foreign and domestic services, and to foreign and local trademarks, copyrights and patents.

3. **Freer trade** – gradually through negotiations– Reducing trade barriers like custom duties, import bans and quotas is one of the most important ways to encourage trade.

4. **Predictability** – through binding and transparency – With stability and predictability, investment can be encouraged and jobs are created. When member countries agree to open their markets for goods and services they bind their commitments which leads to ceilings on custom tariff rates.

5. **Promoting fair competition** – The WTO is a system of rules dedicated to open, fair and undistorted competition.

Role of WTO

World Trade organization (WTO) has a crucial role to play in the international trade, global economics, political and legal issues arising in the international business because of the globalization.WTO has emerged as a world's most powerful institutions for reducing trade related barriers between the countries and opening new markets. The goal of WTO is to provide a fair platform for its member countries to help in services like exports, imports and conduct their business in a peaceful manner.The advantage to the countries being members in the WTO is that that they lower trade related barriers among themselves. In contrary to this the countries which are not part of WTO must negotiate trade related agreements independently with their trading partners. WTO facilitates implementation, administration and smooth operations of trade agreements between the countries. It provides a forum for the trade negotiations between its member countries. Overall WTO was set up to play a very important role in the world economics though settling trade related disputes through rules, regulations and consensus-based agreement mechanisms that would prevent trade related wars between powerful countries. Through resolving trade related disputed WTO has got the potential to maintain world peace and bilateral relations between its member countries thorough following negotiations, consultations and mediations.

Challenges of International Trade

The most common issues you can face doing international trade:

1. Distance: Due to long distance between different countries, it is difficult to establish quick and close trade contacts between traders. Buyers and sellers rarely meet one another and personal contact is rarely possible.
There is a great time lag between placement of order and receipt of goods from foreign countries. Distance creates higher costs of transportation and greater risks.
2. Different languages: Different languages are spoken and written in different countries. Price lists and catalogues are prepared in foreign languages. Advertisements and correspondence also are to be done in foreign languages.
A trader wishing to buy or sell goods abroad must know the foreign language or employ somebody who knows that language.

3. Difficulty in transportation and communication: Dispatch and receipt of goods takes a longer time and involves considerable expenses. During the war and natural calamities, transportation of goods becomes even more difficult. Similarly, the costs of sending or receiving information are very high.

4. Risk in transit: Foreign trade involves much greater risk than home trade. Goods have to be transported over long distances and they are exposed to perils of the sea. Many of these risks can be covered through marine insurance but increases the cost of goods.

5. Lack of information about foreign businessmen: In the absence of direct and close relationship between buyers and sellers, special steps are necessary to verify the creditworthiness of foreign buyers. It is difficult to obtain reliable information concerning the financial position and business standing of the foreign traders. Therefore, credit risk is high.

6. Import and export restrictions: Every country charges customs duties on imports to protect its home industries. Similarly, tariff rates are put on exports of raw materials. Importers and exporters haveto face tariff restrictions. They are required to fulfill several customs formalities and rules. Foreign trade policy, procedures, rules and regulations differ from country to country and keep on changing from time to time.

7. Documentation: Both exporters and importers have to prepare several documents which involve expenditure of time and money.

8. Study of foreign markets: Every foreign market has its own characteristics. It has requirements, customs, weights and measures, marketing methods, etc., of its own. An extensive study of foreign markets is essential for success in foreign trade. It is very difficult to collect accurate and up to date information about foreign markets.

9. Problems in payments: Every country has its own currency and the rate at which one currency can be exchanged for another (called exchange rate) keeps on fluctuating change in exchange rate create additional risk. Remittance of money for payments in foreign trade involves much time and expense.

Due to wide time gap between dispatch of goods and receipt of payment, there is greater risk of bad debts.

10. Frequent market changes: It is difficult to anticipate changes in demand and supply conditions abroad. Prices in international markets may change frequently. Such changes are due to entry of new competitors, changes in buyers' preferences, changes in import duties and freight rates, fluctuations in exchange rates, etc.

ABIT

INTERNATIONAL BUSINESS (MBA 206)

International Trade and Investment (Module-2)

Mitrabinda Nayak

Challenges for global business

1. **International company structure -** If the aim is to be competitive globally, the first consideration is the structure of the organization and the location of the teams in place that's up for the challenge. Coca-Cola offers one example of effective multinational business structure. The company is organized into continental groups, each overseen by a President. The central Presidents manage Presidents of smaller, country-based or regional sub-divisions. Despite its diverse global presence, the Coca-Cola brand and product is controlled centrally and consistent around the world.

2. **Foreign laws and regulations -** From tax implications to trading laws, navigating legal requirements is a central function for any successful international business. A good rule of thumb is to beware of engaging in any questionable activities, which might be legal but could have future reputational repercussions.Employment and labour requirements differ by country. For instance, European countries stipulate that a minimum of 14 weeks maternity leave be offered to employees, while on the other hand, there is no such requirement for U.S. employers.

3. **International accounting -**Different tax systems, rates, and compliance requirements can make the accounting function of a multinational organization significantly challenging. Accounting can present a challenge to multinational businesses who may be liable for corporation tax abroad. Accounting strategy is key to maximizing revenue, and the location where your business is registered can impact tax liability A focus on tax efficiency is often the aim of international accounting efforts.Example: In the European Union, companies may benefit from the Common Consolidated Corporate Tax Base proposal, whereby companies with

operations around the EU can limit tax liability to one corporate center. Since Tax Consolidation is a feature of several multinationals decision to be head-quartered in Dublin, as Ireland is known for it’s “business friendly” corporate tax policy. Well-known companies with operational headquarters in the republic of Ireland include Google, Facebook and Intel.

4. **Cost calculation and global pricing strategy -** One must consider costs to remain competitive, while still ensuring profit. Researching the price of direct, local-market competitors can give a benchmark. Pricing may also come down to how one choose to position their brand. Example: Swedish furniture giant Ikea, known in Europe for its low- cost value, struggled initially in China due to local competitor costs of labour and production being much cheaper. By relocating production for the Chinese market and using more locally sourced materials, the company was able to successfully cut prices to better reflect its brand and boosts sales among target consumers.

5. **Universal payment methods -** The proliferation of international e-commerce websites has made selling goods overseas easier and more affordable for businesses and consumers. However, payment methods that are commonly accepted in home market might be unavailable abroad.Determining acceptable payment methods and ensuring secure processing must be a central consideration for businesses who seeks to trade internationally.Example: Accepting well-known global payment methods through companies like Worldpay,as well as accepting local payment methods, such as JCB in Asia or Yandex Monkey in Russia, can be a good option for large international business. Accepting wire transfers, PayPal payments, and Bit coin, are other possibilities.

6. **Currency rates -** One of the most challenging international business problems to navigate. One way to protect against fluctuations in currency is to pay suppliers and production costs in the same currency as the one we’re selling in. Another option for mitigating the risk of unpredictable currency rates can be setting up a forward contract and agreeing a price in advance for future sales. Example: Henry from Washington D.C has returned from his trip to Europe. He has 81€ that he wants to exchange back to US-Dollars. He goes back into a bank in Washington. Since at the time being the exchange rate of Euro is 137.51. he gets $ 111.38.

7. **Choosing the right global shipment methods -** The choice of shipping method can be a major influence on the revenue and may be a limiting factor to the products that one can variably sell overseas. Other considerations include customs fees, the need and cost of storage, and local methods of distribution. There are also country-specific regulations and shipping requirements to take into account. For a quick check of costs and compliance, UPS international has created an online tool called TradeAbility to help businesses and individuals manage the movement of good overseas.

8. **Communication difficulties and cultural differences -** Good communication is at the heart of the effective international business. Effective communication with colleagues, clients and customers abroad is essential for success. Non-verbal communication can make or break business deals too. Being aware of acceptable business etiquette abroad, and how things like religious and cultural traditions will help to navigate better potential communication problems in international business.

9. **Political risks -**An obvious risk for international business is political uncertainty and instability. Before considering expansion into a new or unknown market, a risk assessment of the economic and political landscape is critical. Issues like ill-defined or unstable policies and corrupt practices can be hugely problematic in emerging markets. Example: Companies like Facebook are banned in China, partially in preference for national social networks and also due to government regulation over internet content.

10. **Supply chain complexity and risks of labour exploitation -**Managing suppliers and supply chains can also be a tricky process. Recent Research revealed that 77% of businesses believe that modern slavery exists at some point in their supply chains.

11. **Worldwide environmental issues -** Sustainability is high on the agenda of many major global corporations. Key considerations like how your production methods might impact the local environment through waste and pollution. With a number of brands such as Dell, Renault and MUD jeans leading a shift towards the circular economy, there is an opportunity and demand for changing production methods and consumer behaviour to establish more sustainable future for the environment and society as a whole.

Global Trade and Investment

Many economists believe that unrestricted (free) trade between nations will raise the economic welfare of all countries that participate in a free trade system.

Free trade: refers to a situation where a government does not attempt to influence through quotas or duties what its citizens can buy from another country or what they can produce and sell to another country.

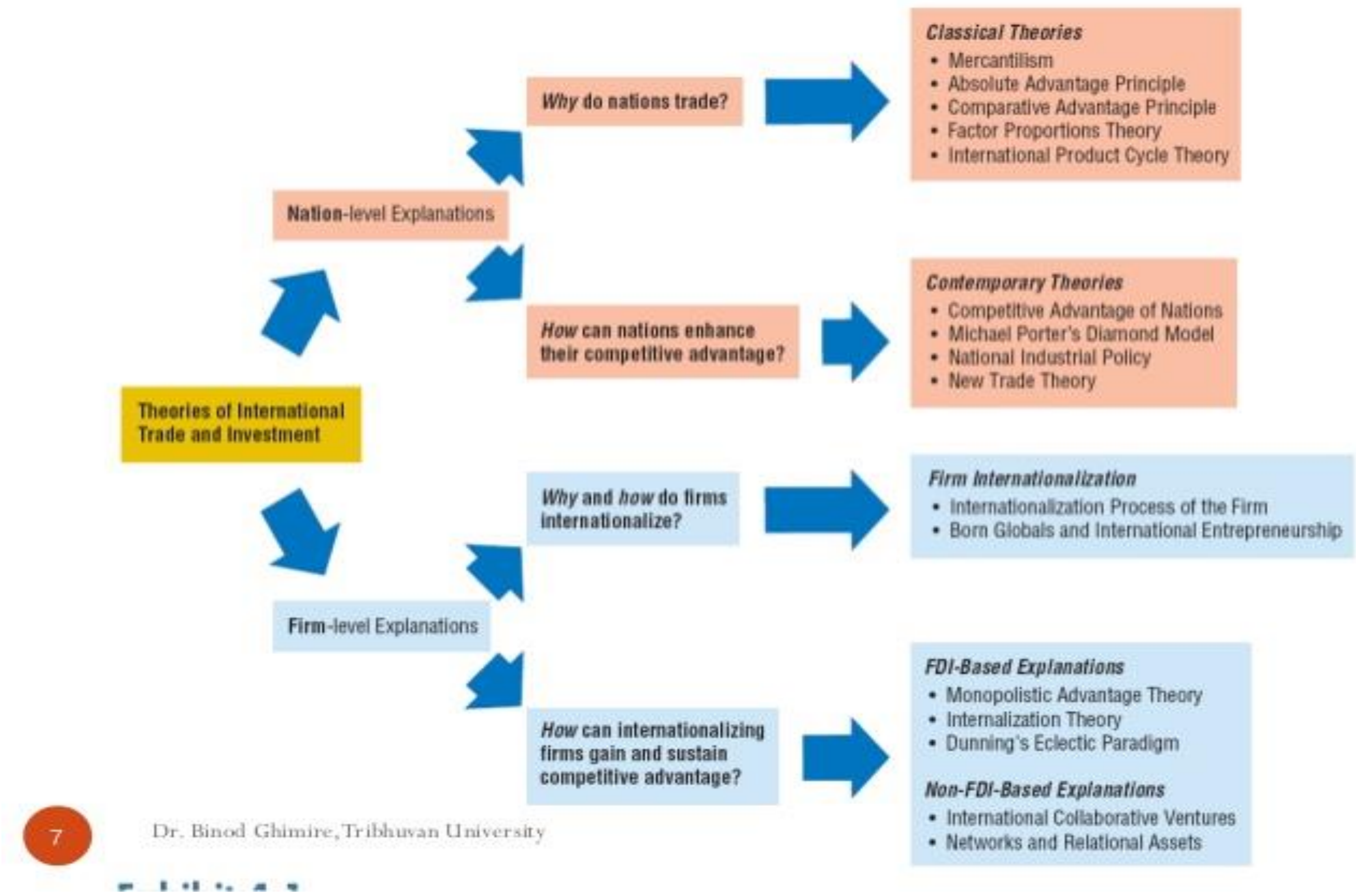
Trade theory: theory that explain (1) why it is beneficial for a country to engage in international trade, and (2) the pattern of international trade that is observed in the world economy.

International trade and foreign investment support the following objectives:

- **i.** Protecting local employment and labour conditions
- **ii.** Reducing economic and political vulnerability
- **iii.** Encouraging diversification of industry
- **iv.** Permitting the development of local technologies
- **v.** Protecting the environment

Theories of International Trade and Investment

An international business theory must look at the distribution of gains from international business activities between the firms involved and the Governments in each country and between (or among) relevant Governments. When Governments wish to redistribute the costs and benefits of international business activities, they impose policies which firms must take into account in their decision- making-and this action/reaction environment is the subject that IB theory must explain.



A. Classical Theories

1. Mercantilism theory

The first theory of international trade, mercantilism, emerged in England in the mid sixteenth century.This prevailed and developed from 1400 to 1770 AD.Systematically developed by an Italian Economist Antonio Serra. The principle assertion of mercantilism was that gold and silver were the mainstays of national wealth and essential to vigorous commerce.At that time, gold and silver were the currency of trade between countries; a country could earn gold and silver by exporting goods.The main belief of mercantilism is to maintain a trade surplus, to export more than it imported. By doing so, a country would accumulate gold and silver and, consequently, increase its national wealth, prestige, and power.Economic assets, or capital, are represented by bullion (gold, silver, and trade value) held by the state, which is best increased through a positive balance of trade with other nations (exports minus imports). Mercantilism suggests that the ruling government should advance these goals by playing a protectionist role in the economy, by encouraging exports through subsidies and discouraging imports, especially through the use of tariffs and quota.Mercantilism, as a creator of surplus, is the means to strengthen political power by making strong nation or government. Philosophy is that political power can be achieved by wealth.A strong government with wealth can improve wealth of the citizen.State intervention is an essential part of Mercantilism.

Criticisms:-

- The flaw with mercantilism was that it viewed trade as a zero-sum game. (A zerosum game is one in which a gain by one country results in a loss by another.)
- Adam Smith and David Ricardo showed the short-sightedness of this approach and demonstrated that trade is a positive- sum game, or a situation in which all countries can benefit.
- Adam Smith attempted to destroy the philosophy by introducing the concept of “free trade” saying let the people trade as they saw fit.

2. Absolute Advantage Theory

In his 1776 landmark book The Wealth of Nations, Adam Smith attacked the mercantilist assumption that trade is a zero-sum game. Smith argued that countries differ in their ability to produce goods efficiently.According to Smith, countries should specialize in the production of goods for which they have an absolute advantage and then trade these for goods produced by other countries.

Assumptions:-

- Production follows laws of constant returns
- There is only one factor of production and labour
- Existence of full employment
- Labour is perfectly mobile within the country but is immobile between the countries.

Country	Watches per hr produced	No. of workers
A	5	3
B	10	3

- Party A can produce 5 watches per hour with 3 employees.
- Party B can produce 10 watches per hour with 3 employees.
- Assuming that the workers of both the countries are paid equally, Country B has an absolute advantage over Country A in producing watches and can produce twice the no. of watches with the same no. of people.

Criticisms:-

- It is applicable only in the case of 2 goods and 2 country model.
- Assumption of this theory is not practical such as Labour is only basis of cost calculation. There is no transportation cost in trade between the countries etc.
- Adam Smith could not give any solution to the countries having absolute cost disadvantage in production of both the goods.

3. Comparative Advantage Theory

A comparative advantage gives a company the ability to sell goods and services at a lower price than its competitors and realize stronger sales margins.David Ricardo stated a theory that other things being equal a country tends to specialize in and exports those commodities in the production of which it has maximum comparative cost advantage or minimum comparative disadvantage. Similarly, the country's imports will be of goods having relatively less comparative cost advantage or greater disadvantage.

Ricardo's Assumptions:-

- There are two countries and two commodities.
- There is a perfect competition both in commodity and factor market.

- Cost of production is expressed in terms of labour i.e. value of a commodity is measured in terms of labour hours/days required to produce it. Commodities are also exchanged on the basis of labour content of each good.
- Labour is the only factor of production other than natural resources.
- Labour is mobile in a country but immobile between two countries.
- There exists free trade between countries.
- There are no transportation costs and no capital movements.
- There is existence of full employment.

Ricardo's Example:

This theory can be explained by taking 2 countries and 2 commodities under the following conditions:

i) One country will produce both the products more effectively than the other country.

ii) A country will be able to produce one product more effectively than the other product.

We take the example of 2 countries – England and India and 2 commodities Cloth

Country	**No. of units of labour per unit of cloth**	**No. of units of labour per unit of rice**	**Exchange Ratio of rice with cloth**	**Exchange Ratio of cloth with rice**
England	**200**	**240**	**1 Rice : 1.2 Cloth**	**1 Cloth : 0.833 Rice**
India	**180**	**160**	**1 Rice : 0.88 Cloth**	**1 Cloth : 1.125 Rice**

and rice.

From this table we note that :

i) India is producing cloth and rice more effectively than England

ii) England is producing cloth more effectively than rice whereas India produces rice more effectively than cloth.

iii) Therefore, in absolute terms England will specialize in production of cloth and India will specialize in production of rice.

iv) Although India has an advantage in both the products still for them to engage in international trade, it will do so.

4. Heckscher-Ohlin Theory

This theory is based on a different explanation of comparative advantage put forward by Swedish economists Eli Heckscher and Bertil Ohlin.It is also called factor-proportions theory. factors in relative abundance are cheaper than factors in relative scarcity.They stated that comparative advantage arises from differences in national factor endowments.Factor Endowment: “It is the extent to which a country is bestowed with such resources as land, labour and capital.”Countries have varying factor endowments and different factor endowments explain differences in factor costs, abundance of a factor lowers its cost.It implies that a country will export goods that use locally abundant factors intensivelyand import goods that use its scarce factors intensively.In the two-factor case, it states: “A capital-abundant country will export the capital-intensive good, while the labour-abundant country will export the labour-intensive good.The relative abundance in capital will cause the capital-abundant country to produce the capital-intensive good cheaper than the labour-abundant country and vice versa.

Pattern of trade in world economies:

i. United States is the most capital-abundant country in the world by any criterion, exhibits low cost capital and imports labour-intensive products. It is also a substantial exporter of agricultural goods by virtue of its abundant arable land.

ii. China leads the world in the export of goods produced in labour- intensive manufacturing industries, such as textile and footwear. This reflects China’s relative abundance of low cost labour.

iii. In Hong Kong and Netherlands land prices are very high because it is in demand, it is why neither Hong Kong nor Netherland excels in the production of goods requiring large amounts of land such as wool or wheat.

iv. Australia and Canada produce these goods because land is abundant compared to the number of people.

Labour-Capital Relationship: In countries where there is little capital available for investment and where the amount of investment per worker is low, managers might expect cheap labour rates and export competitiveness in products requiring large amounts of labour relative to capital. Example is Iran where labour is abundant compared to capital and it excels in the production of homemade carpets. Also exports of emerging economies, show a high intensity of less skilled labour.

Differentiating Heckscher-Ohlin Theory from Comparative Advantage:

i) Like David Ricardo’s theory it also argues that free trade is beneficial.
ii) Unlike absolute concept of comparative advantage, however, Heckscher-Ohlin theory argues that the pattern of international trade is determined by differences in factor endowments, rather than differences in productivity.

Merits of Heckscher-Ohlin Theory

- This explains international trade in terms of general theory of value instead of labour theory.
- It states that the basis of int. trade is the differences in the final price of the commodity between countries which is a more satisfactory explanation than other theories.
- It explains a labour-capital model which is more comprehensive.
- More realistic.
- It explains the reasons behind the differences in cost of production in terms of factor endowments.

Criticisms of Heckscher-Ohlin Theory

- It is static in nature as it doesn’t take into consideration changes in the production function.
- Capital cannot be considered as a natural endowment.
- It assumes that production functions like technology is same for all countries which is unrealistic.

- Unrealistic assumption of full employment and perfect competition.
- It is restrictive as it includes two commodities, two countries and two factors.
- Leontief Paradox: American economist Dr.Wassily Leontief tested H-O theory under U.S.A conditions. He found out that U.S.A exports labour intensive goods and imports capital intensive goods, but U.S.A being a capital abundant country must export capital intensive goods and import labour intensive goods than to produce them at home. This situation is called Leontief Paradox which negates H-O Theory

5. **The International Product Life-Cycle Theory**

The product life-cycle theory was put forward by Raymond Vernon in the mid 1960s.According to the PLC theory of trade, the production location for many products moves from one country to another depending on the stage in the product's life cycle.It was based on the observation that most of 20th century a large proportion of world's new products had been developed by US firms are sold in US markets first (e.g. mass-produced automobiles, televisions, instant cameras, photocopiers, PCs and semiconductor chips).Vernon argued that wealth and size of U.S Market gave U.S firms a strong incentive to develop new products.

Stages 1 - Introduction

- Innovation, Production, and Sales in Same Country.
- Products are developed because there is a nearby observed need and market for them.
- Once a firm has created a new product theoretically it can manufacture that product anywhere in the world.
- However early production occurs domestically to obtain rapid feedback and to reduce transportation cost. Location and Importance of Technology
- Companies use technology to create new products and new ways to produce old products, both of which can give them competitive advantage.
- Dominant position of industrial countries is due to competition, demanding consumers, the availability of scientists and engineers and high incomes.

Stage 2 – Growth

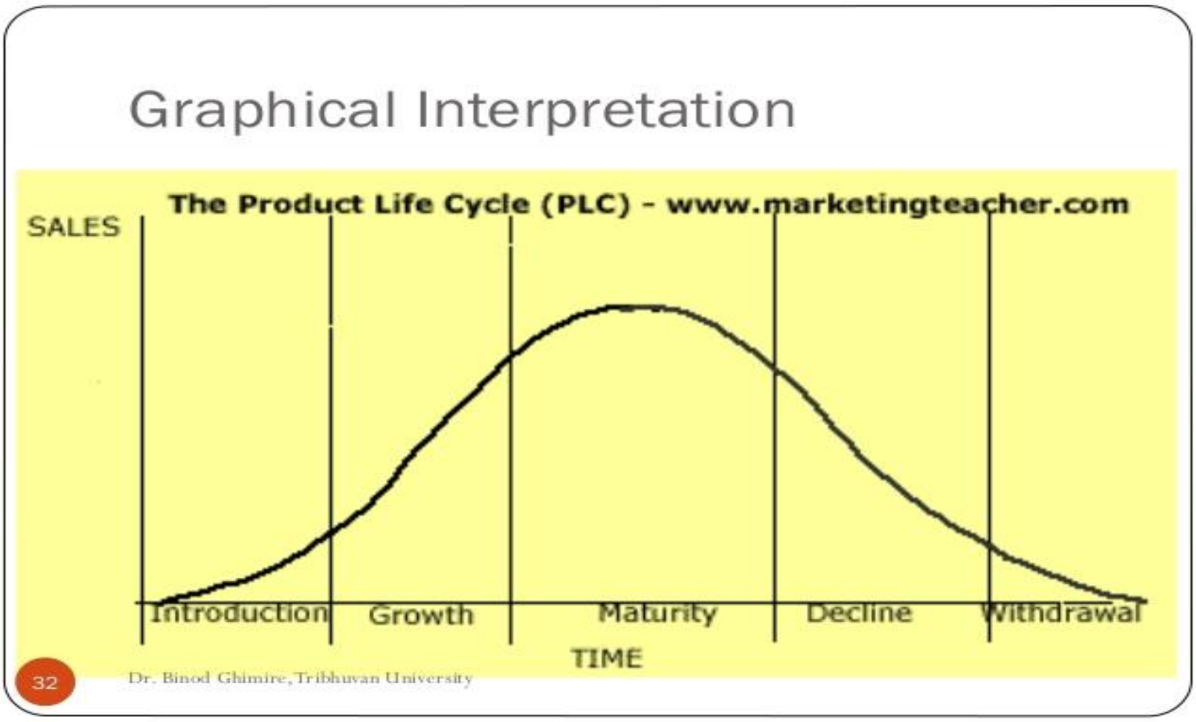
- As sales of the new product grow, competitors enter the market.
- Demand grows substantially in foreign markets, particularly in other industrial countries.
- Demand may be sufficient to justify producing in some foreign markets to reduce or eliminate transportation charges.
- Rapid sales growth at home and abroad compels firms to develop process technology.
- The original producing country will increase its exports in this stage but lose certain key exports markets in which competitors commence local production.

Stage 3 – Maturity

- At the maturity stage, worldwide demand begins to level off, although it may be growing in some countries and declining in others.
- Product models become highly standardized, making cost an important competitive weapon.
- There are incentives to begin moving plants to emerging markets where unskilled, inexpensive labour is efficient for standardized processes. It reduces per unit cost for their output.
- The lower per unit cost creates demand in emerging markets.
- Exports decrease from the innovating country as foreign production displaces it.

Stage 4 – Decline

- As a product moves to the decline stage, those factors occurring during the mature stage continue to evolve.
- The markets in industrial countries decline more rapidly than those in emerging markets as rich customers demand ever-newer products.
- The country in which the innovation first emerged and exported from, becomes the importer.



Verification of PLC Theory

• The PLC theory holds that the location of production to serve world markets shifts as the production move through their life cycle.

• Products such as ballpoint pens and portable calculators have followed this pattern. They were first produced in a single industrial country and sold at high price. Then production shifted to multiple industrial country locations to serve those local markets. Finally, most production is in emerging markets, and prices have declined.

Limitations of PLC Theory

Why shift in production location do not take place for some products?

• Some products due to very rapid innovation, have extremely short life cycles, which make it impossible to achieve cost reduction by moving production from one country to another.

• For example product obsolescence occurs so rapidly for many electronic products.

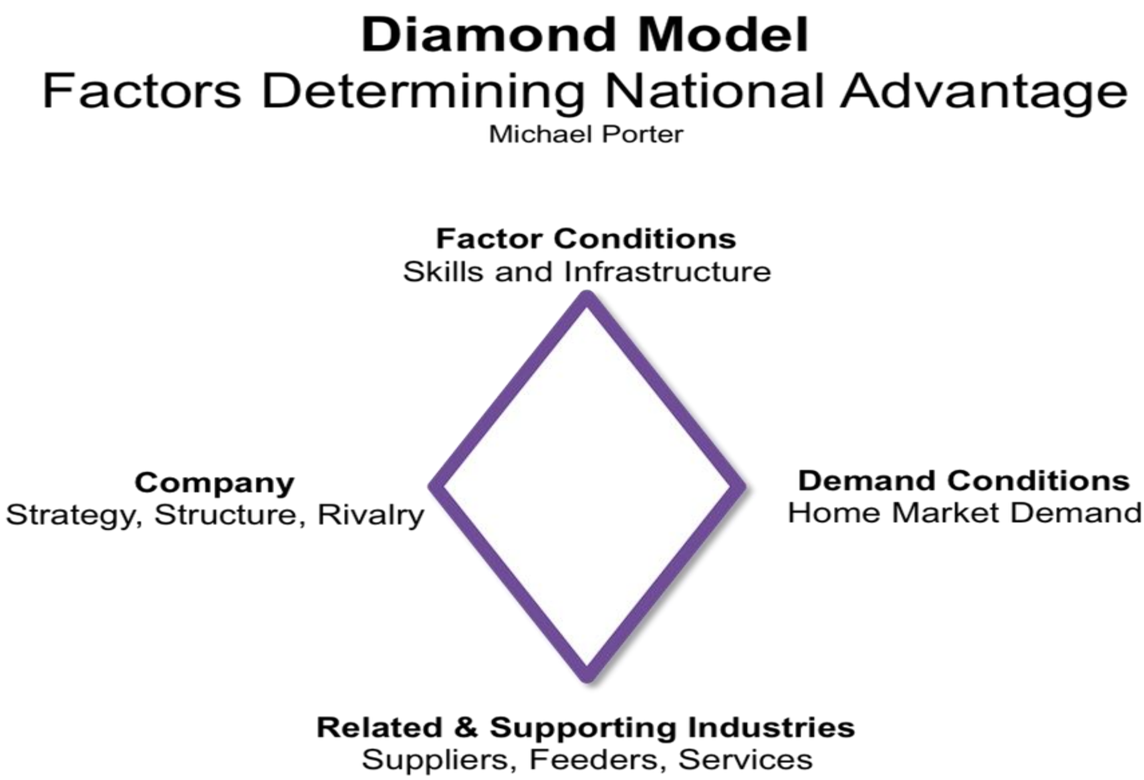
• Luxury products for which cost is of little concern to the consumer. Do not shift their locations.

• Products for which a company can use a differentiation strategy, perhaps though advertising, to maintain consumer demand without competing on the basis of price.

• Products that require specialized technical labour to evolve into their next generation. This seems to explain the long term U.S. dominance of medical equipment production and German dominance in rotary printing press.

6. Porter’s Diamond Theory

Michael E. Porter is a prominent economist and a Harvard Business School fellow. His popularized works are competitive advantage and five forces model which explains why MNCs go worldwide.The Porter’s diamond shows the interaction of four conditions that usually need to be favourable if an industry in a country is to gain a global competitive advantage.Porter analyzed case studies of more than 100 firms and found that the firm that succeeds in global markets first succeeded in intense domestic competition.Michael Porter identified four stages of development in the evolution of a country. The dependent phases are − Factors, Investments, Innovation, and Prosperity.



Porter Diamond

- Firm Strategy, Structure and Rivalry – Competition leads to businesses finding ways to increase production and to the development of technological innovations
- Related Supporting industries – Relates to the upstream and downstream industries that facilitate innovation through exchanging ideas.
- Demand Conditions – Refers to the size and the nature of the customer base for products which in turn drives innovation and product improvement.
- Factor conditions - These are elements which a nation can create for itself like a large pool of skilled labour, technological innovation and capital. Government has to play a major role in this.

Porter's Diamond Theory Contd..

- Porter talked extensively on attributes related to **competitive advantages** which an organization can achieve relative to its rivals which consists of Lower Cost and Differentiation. These advantages derive from factor(s) that permit an organization to outperform its competition, such as superior market position, skills, or resources.
- In Porter's view, the strategic management of businesses should be concerned with creating and continuing competitive advantages.

7. New Trade Theory

New trade theory, developed by many theorists from the late 1970 to early 1980s, is a collection of economic models in international trade.It focuses on increasing return to scale and network effect.Economies of scale are an important factor in some industries for superior international performance – even when the nation has no clear comparative advantage.Some industries succeed best as their volume of production increases.Examples: commercial aircraft, automobiles, pharmaceuticals all have very high fixed costs that require high-volume sales to achieve profitability.

8. Internalization Theory

Internalization theory is a branch of economics that is used to analyse international business behaviour. Internalization theory focuses on imperfections in intermediate product markets.Two main kinds of intermediate product are distinguished –

i) Knowledge flows linking R&D to production
ii) Flows of components and raw materials from an upstream production facility to a downstream one.

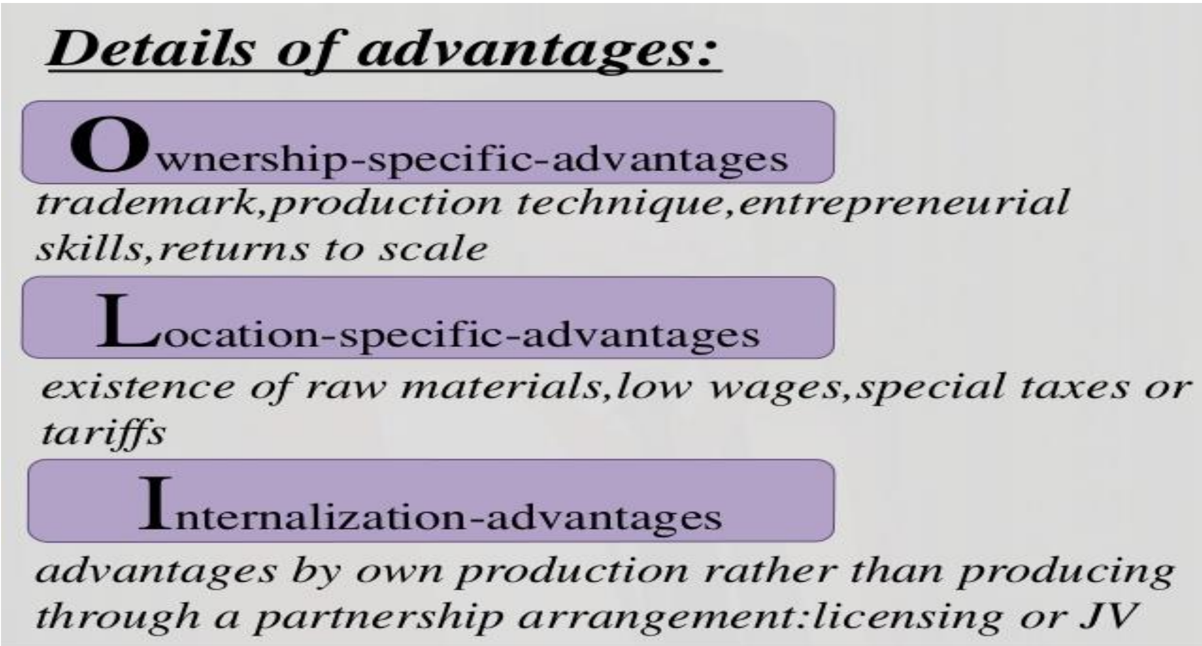
Most applications of the theory focus on knowledge flow. Proprietary knowledge is easier to appropriate when IPR such as patents and trademarks are weak. Even with strong protections firms protect their knowledge through secrecy.Instead of licensing their knowledge to independent local producers, firms exploit it themselves in their own production facilities. In effect, they internalise the market in knowledge within the firm. The theory claims the internalization leads to larger, more multinational enterprises, because knowledge is a public good.Development of a new technology is concentrated within the firm and the knowledge then transferred to other facilities.Internalization occurs only when firms perceive the benefits to exceed the costs. When internalization leads to foreign investment the firm may incur political and commercial risks due to unfamiliarity with the foreign environment. These are known as 'costs of doing business abroad',arising from the 'liability of foreignness'.When such costs are high a firm may license or outsource production to an independent firm; or it may produce at home and export to the country instead.Firms without special knowledge may become multinational to internalise supplies of components or raw materials in order to guarantee quality or continuity of supply, or for tax advantages from transfer pricing.

Transaction Cost is of 3 types :

i) Search and information costs: are costs such as those incurred in determining that the required good is available on the market, which has the lowest price, etc.
ii) Bargaining costs: are the costs required to come to an acceptable agreement with the other party to the transaction, drawing up an appropriate contract and so on. In game theory this is analyzed for instance in the game of chicken. On asset markets and in market microstructure, the transaction cost is some function of the distance between the bid and ask.
iii) Policing and enforcement costs: are the costs of making sure the other party sticks to the terms of the contract, and taking appropriate action (often through the legal system) if this turns out not to be the case.

9. Eclectic Paradigm Theory

The **Eclectic Paradigm**, also known as the **OLI Model or OLIFramework** (*OLI* stands for *Ownership*, *Location*, and *Internalization*), is a theory in economics.It is a further development of the internalization theory and published by John H. Dunning in 1979.This paradigm assumes that institutions will avoid transactions in the open market if the cost of completing the same actions internally, or in-house, carries a lower price.The paradigm provides a strategy for operation expansion through FDI. The goal is to determine if a particular approach provides greater overall value than other available national or international choices for the production of goods or services.Since businesses seek the most cost-effective options while still maintaining quality, they may use the eclectic paradigm to evaluate any scenario which exhibits potential.



i) **Ownership advantages** - specific advantages refer to the competitive advantages of the enterprises seeking to engage in Foreign direct investment (FDI). The greater the competitive advantages of the investing firms, the more they are likely to engage in their foreign production.

ii) **Location advantages -** Locational attractions refer to the alternative countries or regions, for undertaking the value adding activities of multinational enterprises (MNEs). The more the immobile, natural or created resources, which firms need to use jointly with their own competitive advantages, favor a presence in a foreign location, the more firms will choose to augment or exploit their specific advantages by engaging in FDI.

iii) **Internalization advantages -** Firms may organize the creation and exploitation of their core competencies. The greater the net benefits of internalizing cross-border intermediate product markets, the more likely a firm will prefer to engage in foreign production itself rather than license the right to do so.

Example - According to Research Methodology, an independent research and analyst firm, the eclectic paradigm were applied by **Shanghai Vision Technology Company**, in its decision to export its 3D printers and other innovative tech offerings. While their choice strongly considered the disadvantage of higher tariffs and transportation costs, their internationalization strategy ultimately allowed them to flourish in new markets.

10. Theory of International Investment

Internationalinvestments mean investments beyond borders. International investments refer to investments by entities of a nation in nations other than their own. Bertil Ohlin is the founder of the Modern Theory of the Dynamics of Trade. Foreign investments involve export of capital. According to him, it is a process of financing projects which appear crucial when their dynamic nature resists their routine operations. Broadly there are two types of foreign investment, namely, Foreign Direct Investment (FDI) and foreign portfolio investment (FPI). FDI refers to investment in a foreign country where the investor retains control over the investment. It typically takes the form of starting a subsidiary, acquiring a stake in an existing firm or starting a joint venture in the foreign country. Direct investment and management of the firms concerned normally go together. If the investor has only a sort of property interest in investing the capital in buying equities, bonds, or other securities abroad, it is referred to as **portfolio investment**. That is, in the case of portfolio investments, the investor uses capital in order to get a return on it, but has not much control over the use of the capital.FDIs are governed by long-term considerations because these investments cannot be easily liquidated. Hence, factors like long-term political stability, government policy, industrial and economic prospects, etc., influence the FDI decision. However, portfolio investments, which can be liquidated fairly easily, are influenced by short-term gains. Portfolio investments are generally much more sensitive than FDIs to short term uncertainties.The theories of international investments seek to explain the reasons for international investments.Theories of international investment can essentially be divided into two categories:

i) Micro (industrial organization) theories
ii) Macro (cost of capital) theories.

Micro Theories - According to this view, multinationals find it cheaper to expand directly in a foreign country rather than through trade in cases where the advantages associated with cost or product are based on internal, indivisible assets based on knowledge and technology. Alternative explanations for international investment have focused on regulatory restrictions, including tariffs and quotas that either encourage or discourage cross-border acquisitions, depending on whether one considers horizontal or vertical integration's.

Macro Theories – These centred around the flow equilibrium.

The factors which influence the movement of capital are as follows :

1. Short – term capital movements - This depends upon numerous facts ranging from working capital to trade credit, the major components being :

i) Interest Arbitrage
ii) Speculation & Trade Financing
iii) Pace of Adjustments

2. Long – term capital movements– This depends on foreign exchange rates and the attractiveness of a country in terms of exchange rate.

Need for Global Competitiveness

The World Economic Forum defines global competitiveness as "the ability of a country to achieve sustained high rates of growth in gross domestic product (GDP) per capita."

In other words, Global Competitiveness is a firm's ability to sell its product in home and foreign market and the ability to profitably gain and maintain market share in the domestic market.Business firms abide by the rules and regulations formed by the government. The government assumes a very important role in enhancing competitiveness.Governments must promote trade by reengineering systems and procedures. Governments should be more responsive, reducing bureaucratic red tape.

GLOBAL COMPETITIVENESS INDEX - The Global Competitiveness Reports assess the competitiveness landscape of 144 economies of the world. It provides information about the drivers of their productivity and prosperity. The Report is the most comprehensive assessment of national competitiveness worldwide.

Factors Affecting Global Competitiveness

- **Physical infrastructure** plays a critical role in improving the global competitiveness of a country. This will lead to the smoother movement of people, products, and services, facilitating faster delivery of goods and services.
- The business environment should be as such that it improves **coordination among public-sector agencies**. The best methods include providing support and incentives for R&D activities, HRD and education, encouraging innovativeness and creativity, facilitating the improvement of industrial blocks, and productivity enhancements of SMEs.
- **High total factor productivity** (TFP) is a boon for economic growth. It shows the synergy and efficiency of both capital and HR utilization and promotes national competitiveness.
- **Productivity campaigns** are important because they promote public-awareness and provide mechanisms to use the productivity tools and techniques.
- **Intensifying R&D activities** that contribute to creativity, innovation, and indigenous technological development is also an important factor.

- **Improving the capacities of SMEs** to become increasingly productive suppliers and exporters makes strategic sense.

Regional Trading Blocs

Trading Blocs are a group of countries :

- Which are geographically close to each other
- Have similar trade policies
- With their mutual co-operation allow free flow of goods

Trade blocs have liberal rules for the member countries and separate set of rules for the non-member countries.They facilitate trade to member countries of the group but create barriers and block the trade of member countries.

Objectives for Economic Integration / Trading Blocs

1. Stimulates economic growth
2. Reduction of trade barriers among the member countries
3. Maintaining better relations from political angle
4. Imposing barriers on non-member countries
5. Promoting free transfer of labour, capital and other factors
6. Creating common currency
7. Collective Bargaining
8. Assisting member countries
9. Enhancing welfare of consumers

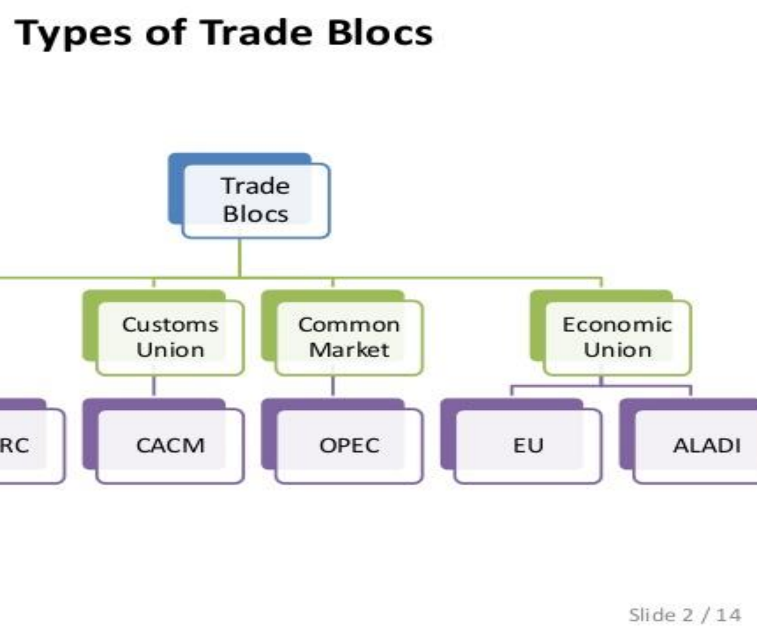
Advantages of Regional Trading Blocs

- **Foreign Direct Investment** − Foreign direct investment (FDI) surges in RTBs and it benefits the economies of participating nations.
- **Economies of Scale** − The larger markets created results in lower costs due to mass manufacturing of products locally. These markets form economies of scale.

- **Competition** − Trade blocs bring manufacturers from various economies, resulting in greater competition. The competition promotes efficiency within firms.
- **Trade Effects** − As tariffs are removed, the cost of imports goes down. Demand changes and consumers become the king.
- **Market Efficiency** − The increased consumption, the changes in demand, and a greater amount of products result in an efficient market.
- Co-operative Spirit
- Expansion of Markets
- Growth and Development of the region
- Uniform policies
- Benefits to consumers of member countries
- Free transfer of resources / factors

Disadvantages of Regional Trading Blocs

- **Regionalism** − Trading blocs have bias in favour of their member countries. These economies establish tariffs and quotas that protect intra-regional trade from outside forces. Rather than following the World Trade Organization, regional trade bloc countries participate in regionalism.
- **Loss of Sovereignty** − A trading bloc, particularly when it becomes a political union, leads to partial loss of sovereignty of the member nations.
- **Concessions** − The RTB countries want to let non-member firms gain domestic market access only after levying taxes. Countries that join a trading bloc needs to make some concessions.
- **Interdependence** − The countries of a bloc become interdependent on each other. A natural disaster, conflict, or revolution in one country may have adverse effect on the economies of all participants.



Free Trade Area (FTA)

- The Free Trade Area is the basic form of economic integration which abolishes all tariffs and non-tariff barriers on trade among the member countries.
- They can however maintain tariffs and non-tariff barriers on trade among the non-member countries.
- IN FTA each member country continues to set its own policies in relation to non-members.
- Examples –

i)North American Free Trade Area (NAFTA)

ii)Latin American Free Trade Area (LAFTA)

iii)European Free Trade Area (EFTA)

Customs Union

A Customs Union is a more advanced level of economic integration than the FTA.

- The member countries have two basic features :

i) The member countries abolish all restrictions and barriers on trade among themselves or charge low rates of tariff.

ii) They adopt a uniform trade policy of barriers and restrictions w.r.t non-members.

- The purpose of establishing a CU normally include increasing economic efficiency and establishing close political and cultural ties between the member countries.
- Examples –

i) Central American Common Market (CACM)

ii) Andean Pact (between Bolivia, Columbia Ecuador & Peru)

Common Market

- This is a type of trade bloc which is composed of a Customs Union with common policies on product regulation and freedom of movement of factors of production.
- Thus, labour and capital are free to move and there are no restrictions on immigration, emigration or cross-border flows of capital between member countries.
- This market gives scope for competitive market forces.
- Inter-regional trade within the common market would solely depend on the comparative advantage of the member nations.
- Examples – Organization of the Petroleum Exporting Countries (OPEC)

Economic Union

- This is the most advanced level of Economic Integration.
- The member countries eliminate all barriers to trade among themselves or charge low tariff.
- The members adopt a uniform commercial policy of barriers to trade against the non-member countries.
- Freedom of movement of HR and capital among the member countries.

- The member nations maintain a fiscal discipline, stability in exchange rates & interest rates by maintaining unified fiscal and monetary policies.
- Example - European Union

European Free Trade Area (EFTA)

- The European Free Trade Association (EFTA) is a free trade organization between four European countries that operates in parallel with – and is linked to – the European Union (EU).
- The EFTA was established on 3 May 1960 as a trade bloc- alternative for European states who were either unable or unwilling to join then-European Economic Community (EEC) which has now become the EU.
- Today's EFTA members are Iceland, Liechtenstein, Norway, and Switzerland, of which the latter two were founding members.
- Since 1995, only two founding members remain, namely Norway and Switzerland. The other five, Austria, Denmark, Portugal, Sweden and the United Kingdom, joined the EU at some point in the intervening years. The initial Stockholm Convention was superseded by the Vaduz Convention, which aimed to provide a successful framework for continuing the expansion and liberalization of trade, both among the organization's member states and with the rest of the world.

About EFTA

- **Governance -** EFTA is governed by the **EFTA Council** and serviced by the **EFTA Secretariat**. In addition, in connection with the EEA (European Economic Area) Agreement of 1992, two other EFTA organizations were established, the **EFTA Surveillance Authority and the EFTA Court.**
- **Locations -** The EFTA Secretariat is headquartered in Geneva, Switzerland, but also has duty stations in Brussels, Belgium and Luxembourg. The EFTA Surveillance Authority has its headquarters in Brussels, Belgium (the same location as the headquarters of the European Commission), while the EFTA Court has its headquarters in Luxembourg (the same location as the headquarters of the European Court of Justice).
- **International relationships -** EFTA has several free trade agreements with non-EU countries as well as declarations on cooperation and joint workgroups to

improve trade. Currently, the EFTA States have established preferential trade relations with 24 states and territories, in addition to the 28 member states of the European Union

European Union (EU)

• The European Union is a unified trade and monetary body of 28 member countries.

• It eliminates all border controls between members. That allows the free flow of goods and people, except for random spot checks for crime and drugs. The EU transmits state-of-the-art technologies to its members. The areas that benefit are environmental protection, research and development, and energy.

• Public contracts are open to bidders from any member country. Any product manufactured in one country can be sold to any other member without tariffs or duties. Taxes are all standardized. Practitioners of most services, such as law, medicine, tourism, banking, and insurance, can operate in all member countries. As a result, the cost of airfares, the internet, and phone calls have fallen dramatically.

• **Purpose -** Its purpose is to be more competitive in the global marketplace. At the same time, it must balance the needs of its independent fiscal and political members.

• **EU Members -** The EU's 28 member countries are: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom. That has dropped to 27 after Brexit caused the United Kingdom to leave the EU in 2019.

History

• In 1950, the concept of a European trade area was first established. The European Coal and Steel Community (ECSC) had 6 founding members: Belgium, France, Germany, Italy, Luxembourg, and the Netherlands.

• In 1957, the Treaty of Rome established a common market. It eliminated customs duties in 1968. It put in place standard policies, particularly in trade and agriculture.

• In 1973, the ECSC added Denmark, Ireland, and the United Kingdom. It created its first Parliament in 1979. Greece joined in 1981, followed by Spain and Portugal in 1986.

• In 1993, the **Treaty of Maastricht** established the European Union common market.

• Two years later, the EU added Austria, Sweden, and Finland. In 2004, twelve more countries joined: Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, and Slovenia.

• In 2009, the **Treaty of Lisbon** increased the powers of the European Parliament. It gave the EU the legal authority to negotiate and sign international treaties. It increased EU powers, border control, immigration, judicial cooperation in civil and criminal matters, and police cooperation. It abandoned the idea of a European Constitution. European law is still established by international treaties

Governance of the European Union (EU)

Three bodies run the EU.

i) **The European Council** – This is the administrative body of the EU. Each member country is represented by a minister in this council and holds the presidency of the council for a period of 6 months by rotation. The secretariat is called the "Corper" which acts as a link between eh EU and the member countries. The EU Council sets the policies and proposes new legislation.

ii) **The European Commission** – It is the executive body of the EU and is headquartered in Brussels. The members of this commission are appointed for a period of 4 years and can be renewed. The Commission is comprised of Commissioners from the member country who look after 23 departments like agriculture, transportation etc and their commitment s to that work and not their own country. They make sure all members act consistently in regional, agricultural, and social policies. The European Commission staffs and executes the laws.

iii) **The European Parliament -** It is composed of 785 members elected by the popular vote once every 5 years from the 27 member countries. The Parliament provides consultation and information to the commission, approves / rejects drafts prepared by the commission and dismisses the commission if required. The European Parliament debates and approves the laws proposed by the Council.

iv) The additional bodies which help in the functioning of the EU are :

v) i) **Court of Justice** – This adjudicates disputes relating to the European Constitution in areas like agriculture,, trade, business disputes etc among member nations. This court has 15 judges and is based in Luxembourg.

vi) ii) **Court of Auditors** – This court is responsible for auditing the reports of the European economic community, monitoring its expenditure and laying down improved plans and procedures for collection of data and levies.

vii) iii) **Advisory Committee** – This includes many committees under its aegis like the European Economic & Social Committee, Monetary Commission and Consultative Committee on coal and steel industry.

Euro Currency

• It was introduced on 1st January 1999.

• It became the official currency of 11 member nations in 1999.

• At present it is the official currency of 18 member states.

• It is the world's second largest reserve currency after the U.S. dollar.

• The eurozone consists of all countries that use the Euro.

• The European Central Bank is the EU's central bank. It sets monetary policy and manages bank lending rates and foreign exchange reserves.

The Schengen Area

• The Schengen Area guarantees free movement to those legally residing within its boundaries.

• Residents and visitors can cross borders without getting visas or showing their passports. In total, there are 26 members of the Schengen Area.

• They are Austria, Belgium, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Italy, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, and Switzerland.

• 2 EU countries, Ireland and the United Kingdom, have declined the Schengen benefits.

• 4 non-EU countries, Iceland, Liechtenstein, Norway, and Switzerland have adopted the Schengen Agreement.

• 3 territories are special members of the EU and part of the Schengen Area: the Azores, Madeira, and the Canary Islands. Three countries have open borders with the Schengen Area: Monaco, San Marino, and Vatican City.

Economy, Challenges & Opportunities of the EU

• The EU's trade structure has propelled it to become the world's second-largest economy after China. In 2018, its GDP was $22 trillion, while China's was $25.3 trillion.

• But the EU's success is not evenly distributed. Italy, Greece, and Cyprus have high levels of public and private debt, including bad bank loans. Italy also has high unemployment while France suffers from low productivity. Germany has a large trade surplus. Many countries need reforms of their pension systems and labour markets.

• **Brexit.** On June 23, 2016, the United Kingdom voted to leave the European Union. And finally completed the process in 2019. The uncertainty dampened business growth for companies that operate in Europe. U.S. companies are the largest investors in Great Britain.As of 2016, the U.S. had invested $588 billion in Britain, while British companies employed more than a million people in the States. Britain's investment in the United States is at the same level. That could impact up to 2 million U.S. / U.K. jobs.

Why Brexit - Many in the United Kingdom, as in other EU nations, worried about the free movement of immigrants and refugees. They don't like the budgetary constraints and regulations imposed by the EU. They want to enjoy the benefits of free movement of capital and trade but not the costs.

• **Immigration Crisis.** In 2015, 1.2 million refugees from Africa and the Middle East poured through Europe's borders.[9] On New Year's Eve 2016, gangs of young refugees across Germany robbed, injured, and sexually assaulted more than 1,200 people, primarily women. As a result, many EU countries sealed off their borders. That stranded 8,000 immigrants in Greece. The EU signed an agreement with Turkey to take back refugees who had reached Greece. In return, the EU would pay

Turkey 6 billion euros. Immigration is the main reason the U.K. majority voted for Brexit.

North American Free Trade Agreement (NAFTA)

- The North American Free Trade Agreement is a treaty between Canada, Mexico, and the United States.
- NAFTA is the largest free trade agreement in the world.
- It was signed by President Clinton and implemented in 1994.
- NAFTA was created for the United States, Canada, and Mexico in answer to trade competition posed by China and the EU.
- Through NAFTA, the three signatories agree to remove trade barriers between them.
- By eliminating tariffs, NAFTA increases investment opportunities.
- That makes NAFTA the world's largest free trade agreement. As the GDP of its three members is more than $20 trillion.
- NAFTA is the first time two developed nations signed a trade agreement with an emerging market country.
- The NAFTA agreement is 2,000 pages, with eight sections and 22 chapters.
- In 2018, NAFTA was renegotiated. It emerged under a new name, USMCA.
- As of February 2020, NAFTA is still in effect, pending USMCA's ratification by Canada.

Why was NAFTA formed?

- About one-fourth of all U.S. imports, such as crude oil, machinery, gold, vehicles, fresh produce, livestock, and processed foods, originate from Canada and Mexico, which are the U.S.'s second- and third-largest suppliers of imported goods.
- In addition, approximately one-third of U.S. exports, particularly machinery, vehicle parts, mineral fuel/oil, and plastics are destined for Canada and Mexico.

Objectives of NAFTA

- Eliminate barriers to trade and facilitate the cross-border movement of goods and services among the three member nations.

- Promote conditions of fair competition in the free trade area by reducing the prices of goods and services.
- Increase business opportunities particularly in Mexico.
- Provide adequate and effective protection & enforcement of IPR throughout the region.
- Generate employment.

Features of NAFTA

- NAFTA grants the **MFN status** to all co-signers.That means countries must give all parties equal treatment. That includes FDI. They cannot give better treatment to domestic investors than foreign ones. They can't offer a better deal to investors from non-NAFTA countries. Governments must also offer federal contracts to businesses in all three NAFTA countries.
- NAFTA **eliminates tariffs** on imports and exports between the three countries. NAFTA created specific rules to regulate trade in farm products, automobiles, and clothing. These also aplply to some services, such as telecommunications and finance.
- Exporters must get **Certificates of Origin** to waive tariffs. That means the export must originate in the United States, Canada, or Mexico. A product made in Peru but shipped from Mexico will still pay a duty when it enters the United States or Canada.
- NAFTA establishes procedures to **resolve trade disputes**.It protects businesses from unfair practices.The NAFTA Secretariat facilitates an informal resolution between the parties. If this doesn't work, it establishes a panel to review the dispute. That helps all parties to avoid costly lawsuits in local courts. It helps the parties interpret NAFTA’s complex rules and procedures. These trade dispute protections apply to investors as well.
- All NAFTA countries must respect **patents, trademarks, and copyrights**. At the same time, the agreement ensures that these intellectual property rights don’t interfere with trade.
- The agreement allows **business travellers easy access** throughout all three countries.
- NAFTA has two other agreements that update the original. The North American Agreement on Environmental Cooperation supports the enforcement of

environmental laws.The North American Agreement on Labour Cooperation protects working conditions.

Impact of NAFTA - Advantages & Disadvantages

Advantages

- U.S. grocery prices would be higher without tariff-free imports from Mexico.
- Imported oil from both Canada and Mexico has prevented higher gas prices.
- NAFTA has also increased trade and economic growth for all three countries.
- NAFTA increased farm exports of the U.S due to elimination of high Mexican tariff in beef, rice, soya meal, corn, apple and beans.
- By shifting production to Mexico where labour is comparatively cheaper especially in auto industry, American companies have benefited immensely.
- Maquiladors are the Mexican factories that make goods and parts of process food for export back to the U.S. They have benefited under NAFTA.

Disadvantages

- Some argue that it sent many U.S. manufacturing jobs to lower-cost Mexico.
- Workers who kept jobs in those industries had to accept lower wages.
- Mexico's workers suffered exploitation in its maquiladora programs.

Future of NAFTA

- President Trump made a campaign promise to repeal NAFTA, and in August 2018, he announced a new trade deal with Mexico to replace it.
- In September 2018, Canada joined the deal: the United States-Mexico-Canada Agreement (USMCA), which was signed into effect on November 30, 2018.
- The new deal is called the United States-Mexico-Canada Agreement. It must be ratified by each country's legislature. The implementation act passed the House in December 2019, the Senate on Jan. 16, 2020, and signed by Trump on Jan. 29, 2020.
- It was ratified in Mexico in 2019 and the ratification is pending in Canada.
- Until the USMCA is ratified, NAFTA remains in effect.

- The Trump administration wanted to lower the trade deficit between the United States and Mexico.
- The new deal changes NAFTA in six areas, the most important being that the auto companies must manufacture at least 75% of the car's components in the USMCA's trade zone

Andean Community

- The “Andean Community” or A.C., previously known as the “Andean Pact”, is an intergovernmental organization created by Bolivia, Peru, Venezuela, Columbia and Ecuador with the aim to promote the expansion of markets and guarantee an effective economic development to the region.
- In the sixties the failure of the first sub-continental integration initiative, the Latin American Free Trade Association (LAFTA), favoured the increase of sub-regional integration blocs.
- Among these, the Andean Group was created in 1969 by the Cartagena Agreement.
- At the end of the 80s, the Andean Group towards an open regionalism that favoured the elimination of tariff barriers and the signing of trade agreements with various economical centers worldwide.
- In the 1990's, the Andean Community integration gained and the common rules adopted in various sectors, such as agriculture, intellectual property, investment, competition and trade defense instruments also created optimum conditions for economic growth and integration.
- The Andean Pact was transformed into the Andean Community and the Andean Integration System (AIS) became the space that brings together the various institutions, governmental agencies and community bodies.

The ACN structure and decision-making procedures

1) **Andean Council of Presidents –**

- The Andean Presidential Council is the highest body of the Cartagena Agreement.

- Made by the Heads of State of the member countries, the Council meets annually in regular sessions with the aim to define the overall policy process.
- The Presidents establish work guidelines and priorities and, in general, indicate the direction of the integration in its different aspects.

2) Andean Council of Foreign Affairs

- The Andean Council of Foreign Ministers is composed by the Foreign Ministers of the member countries.
- It is responsible for ensuring that the objectives of Andean sub regional integration are attained and for making and carrying out the Andean Community's foreign policy.

3) Andean Community Commission

- Drawing a parallel with the European Union, the AC Commission fulfils almost the same attributions.
- It is made up of four country representatives, one of them being the Chairman.
- As for the General Secretariat, it is provided that it has to act solely in the interests of the Sub region. It is one of the main institutions and has to give technical support to any institution of the Andean Integrated System.

4) Andean Parliament

- The policy advisory body is situated in Bogota, Columbia.
- It consists of 5 members of the Parliament from each member country, directly elected for a 5 year term.

5) Andean Community Court of Justice

- As the Andean Parliament, the Andean Court of Justice is part of the 1979 reform. Both complete the Andean Integration System and make it more similar to democracy standards with the presence of the three separated powers.

- The creation of the Court of Justice can also be considered a response to high criticism of human rights and democracy principles violations in the 1970’s- 1980’s in South America.

Scope of the Andean Community

1. Managing and perfecting this enlarged market.
2. Tariff policy
3. Rules of origin
4. Dumping & Subsidies
5. Corrective duties for tariff differences
6. Free Competition
7. Technical Barriers to Trade
8. Trade in agricultural products
9. Andean Agricultural Health System
10. Customs procedures and Systems

Advantages of AC

- Freedom of Movement of Goods
- Freedom of Movement of Services
- Freedom of Movement of Capital
- Freedom of Movement of People
- Common Foreign Policy
- Regional unity and positive intra-regonal relations
- Social & Cultural Identity

Association of South East Asian Nations (ASEAN)

- ASEAN was created on August 8, 1967, in Bangkok, Thailand.
- It was founded by Indonesia, Malaysia, Philippines, Singapore, and Thailand.
- Currently ASEAN has 10 members. The two largest economies are both founding members, Indonesia and Thailand. The other eight countries hope to boost their much smaller economies by exporting to the markets of the larger countries.

- The member nations are Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam.

Objectives of ASEAN

(1) To accelerate the economic growth, social progress and cultural development in the region through joint endeavors in the spirit of equality and partnership in order to strengthen the foundation for a prosperous and peaceful community of Southeast Asian nations.

(2) To promote regional peace and stability through abiding respect for justice and the rule of law in the relationship among countries in the region and adherence to the principles of the United Nations Charter.

In 1995, the ASEAN Heads of State and Government re-affirmed that "Cooperative peace and shared prosperity shall be the fundamental goals of ASEAN."

Principles of ASEAN

The guiding principles of the ASEAN are :

- Mutual respect for the independence, sovereignty, equality, territorial integrity, and national identity of all nations
- The right of every State to lead its national existence free from external interference, subversion, or coercion
- Non-interference in the internal affairs of one another
- Settlement of differences or disputes by peaceful manner
- Renunciation of the threat or use of force and
- Effective cooperation among themselves

Important Milestones

- 1967 - ASEAN Declaration, Bangkok
- 1971 - Zone of Peace, Freedom and Neutrality Declaration, Kuala Lumpur
- 1976 - Declaration of ASEAN Concord, Bali; **Treaty of Amity and Cooperation (TAC)** in Southeast Asia. ASEAN Member States are urged to

settle disputes through friendly negotiations applying the procedures of the TAC.

- 1992 – In the 4th ASEAN Summit in Singapore, a new scheme was launched, named **ASEAN Free Trade Area (AFTA)**. The strategic objective of AFTA was to increase the region's competitive advantage as a single production unit.
- 1997 - The ASEAN adopted **ASEAN Vision 2020**, aimed at improving upon and developing closer economic integration to facilitate free flow of goods, services, investments, capital, equitable economic development and reduction of poverty.
- 2001 - Declaration on Joint Action to Counter Terrorism
- 2003 - Declaration of ASEAN Concord II, Bali
- 2007 - ASEAN Convention on Counter Terrorism (ACCT), 11 January 2007
- 2016 - Joint Declaration of the ASEAN Defence Ministers on Promoting Defence Cooperation for a Dynamic ASEAN Community

Trade Agreements with other countries

- ASEAN – China Free Trade Area (ACFTA) :- Agreement between ASEAN and China, signed in 2002.
- ASEAN – India Free Trade Area :- Agreement between ASEAN and India, signed in 2009.
- ASEAN Economic Community (AEC) :- The aim of AEC is to attract FDI in the ASEAN countries especially from India and China. They aim to do this by establishing :
    i. A single market production base
    ii. A highly competitive regional organization
    iii. An organization promoting equitable economic development
    iv. A regional organization fully integrated with world economy
    v. ASEAN Plus Three (APT):- Forum between ASEAN and 3 East Asian nations of China, Japan & South Korea in 1997. The cooperation areas include food and energy security, disaster management, rural development, poverty alleviation.

South Asian Association for Regional Cooperation (SAARC)

- The South Asian Association for Regional Cooperation (SAARC) was established with the signing of the **SAARC Charter** in Dhaka on 8 December 1985.
- The idea of regional cooperation in South Asia was first raised in November 1980.
- After consultations, the foreign secretaries of the seven founding countries—Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka—met for the first time in Colombo in April 1981.
- Afghanistan became the newest member of SAARC at the 13th annual summit in 2005.
- The **Headquarters and Secretariat** of the Association are at **Kathmandu, Nepal**.

Member Countries & Observers

- SAARC comprises of eight member States:

1. Afghanistan
2. Bangladesh
3. Bhutan
4. India
5. Maldives
6. Nepal
7. Pakistan
8. Sri Lanka

- There are currently nine Observers to SAARC, namely: (i) Australia; (ii) China; (iii) the European Union; (iv) Iran; (v) Japan; (vi) the Republic of Korea; (vii) Mauritius; (viii) Myanmar; and (ix) the United States of America.

Principles of SAARC

Cooperation within the framework of the SAARC shall be based on:

- Respect for the principles of **sovereign equality, territorial integrity, political independence, non-interference** in the internal affairs of other States and mutual benefit.
- Such cooperation shall not be a substitute for bilateral and multilateral cooperation but shall complement them.
- Such cooperation shall not be inconsistent with bilateral and multilateral obligations.

The Objectives of the SAARC

- To **promote the welfare** of the people of South Asia and to improve their quality of life.
- To **accelerate economic growth,** social progress and cultural development in the region and to provide all individuals the opportunity to live in dignity and to realize their full potentials.
- To **promote and strengthen collective self-reliance** among the countries of South Asia.
- To **contribute to mutual trust,** understanding and appreciation of one another's problems.
- To **promote active collaboration** and mutual assistance in the economic, social, cultural, technical and scientific fields.
- **To strengthen cooperation with other developing countries.**
- To **strengthen cooperation among themselves in international forums** on matters of common interests; and
- To cooperate with international and regional organizations with similar aims and purposes.

Areas of Cooperation

- Human Resource Development and Tourism
- Agriculture and Rural Development
- Environment, Natural Disasters and Biotechnology
- Economic, Trade and Finance
- Social Affairs
- Information and Poverty Alleviation

- Energy, Transport, Science and Technology
- Education, Security and Culture and Others

Principal Organs

- **Summits - Meeting of Heads of State or Government -** Meetings are held at the Summit level, usually on an annual basis.
- **Standing Committee of Foreign Secretaries -** The Committee provides overall monitoring and coordination, determines priorities, mobilizes resources, and approves projects and financing.
- **Secretariat –**

The SAARC Secretariat was established in Kathmandu on 16 January 1987. Its role is to coordinate and monitor the implementation of SAARC activities, service the meetings of the association and serve as a channel of communication between SAARC and other international organizations.

The Secretariat comprises the secretary-general, seven directors, and the general services staff. The secretary-general is appointed by the Council of Ministers on the principle of rotation, for a non-renewable tenure of three years.

SAARC Specialized Bodies

1) **SAARC Development Fund (SDF):**

Its primary objective is funding of project-based collaboration in social sectors such as poverty alleviation, development, etc.

SDF is governed by a Board consisting of representatives from the Ministry of Finance of the Member States. The Governing Council of SDF (Finance Ministers of MSs) oversees the functioning of the Board.

2) South Asian University

- **South Asian University (SAU)** is an international university, located in India. Degrees and Certificates awarded by the SAU are at par with the respective Degrees and Certificates awarded by the National Universities/ Institutions.

3) South Asian Regional Standards Organization

- **South Asian Regional Standards Organization** (SARSO) has its Secretariat at **Dhaka, Bangladesh**.
- It was established **to achieve and enhance coordination and cooperation among SAARC member states** in the fields of standardization and conformity assessment and is aimed to develop harmonized Standards for the region to facilitate intra-regional trade and to have access in the global market.

4) SAARC Arbitration Council

- It is an **inter-governmental body** having its office in **Pakistan** is mandated to provide a legal framework/forum within the region for fair and efficient settlement of commercial, industrial, trade, banking, investment and such other disputes, as may be referred to it by the member states and their people.

SAARC and its Importance

- SAARC **comprises 3% of the world's area, 21% of the world's population** and **3.8%** (US$2.9 trillion) **of the global economy**.
- **Creating synergies:** It is the world's most densely populated region and one of the most fertile areas. SAARC countries have common tradition, dress, food and culture and political aspects thereby synergizing their actions.
- **Common solutions:** All the SAARC countries have common problems and issues like poverty, illiteracy, malnutrition, natural disasters, internal conflicts, industrial and technological backwardness, low GDP and poor socio-economic condition and uplift their living standards thereby creating common areas of development and progress having common solutions.

SAARC Achievements

- **Free Trade Area (FTA):** SAARC is comparatively a new organization in the global arena. The member countries have established a **Free Trade Area (FTA)** which will increase their internal trade and lessen the trade gap of some states considerably.

- **SAPTA: South Asia Preferential Trading Agreement** for promoting trade amongst the member countries came into effect in 1995.
- **SAFTA: A Free Trade Agreement** confined to goods, but excluding all services like information technology. Agreement was signed to reduce customs duties of all traded goods to zero by the year 2016.
- **SAARC Agreement on Trade in Services (SATIS):** SATIS is following the GATS-plus 'positive list' approach for trade in services liberalization.
- **SAARC University:** Establish a SAARC university in India, a food bank and also an energy reserve in Pakistan.

Significance for India

- **Neighbourhood first:** Primacy to the country's immediate neighbours.
- **Geostrategic significance:** Can counter China (OBOR initiative) through engaging Nepal, Bhutan, the Maldives and Sri Lanka in development process and economic cooperation.
- **Regional stability:** SAARC can help in creation of mutual trust and peace within the region.
- **Global leadership role:** It offers India a platform to showcase its leadership in the region by taking up extra responsibilities.
- **Game changer for India's Act East Policy:** by linking South Asian economies with it will bring further economic integration and prosperity to India mainly in the Services Sector.

Challenges

- **Low frequency of meetings:** More engagement is required by the member states and instead of meeting biennial meetings should be held annually.
- **Broad area of cooperation** leads to diversion of energy and resources.
- **Limitation in SAFTA:** The implementation of SAFTA has not been satisfactory a Free Trade Agreement confined to goods, excluding all services like information technology.
- **Indo-Pak Relations:** Escalated tension and conflict between India and Pakistan have severely hampered the prospects of SAARC.

Strategy of International Business

Stages in International Strategic Planning - Strategic management process has following four steps:

1. **Environmental Scanning-** Environmental scanning refers to a process of collecting, scrutinizing and providing information for strategic purposes. It helps in analyzing the internal and external factors influencing an organization. After executing the environmental analysis process, management should evaluate it on a continuous basis and strive to improve it.
2. **Strategy Formulation-** Strategy formulation is the process of deciding best course of action for accomplishing organizational objectives and hence achieving organizational purpose. After conducting environment scanning, managers formulate corporate, business and functional strategies.
3. **Strategy Implementation-** Strategy implementation implies making the strategy work as intended or putting the organization’s chosen strategy into action. Strategy implementation includes designing the organization’s structure, distributing resources, developing decision making process, and managing human resources.
4. **Strategy Evaluation-** Strategy evaluation is the final step of strategy management process. The key strategy evaluation activities are: appraising internal and external factors that are the root of present strategies, measuring performance, and taking remedial / corrective actions. Evaluation makes sure that the organizational strategy as well as it’s implementation meets the organizational objectives.

These components are steps that are carried, in chronological order, when creating a new strategic management plan. Present businesses that have already created a strategic management plan will revert to these steps as per the situation’s requirement, so as to make essential changes.

Strategic Compulsions

- To survive in the world of cut-throat competition, companies must sell their products in the global market. It is necessary to come up with new strategies to win more customers.
- Effective strategic management requires strategic estimation, planning, application and review/control.
- The path for strategic management is activated by compulsions like modern developments in the societal and economic theory and the recent changes in the form of business, apart from the economic context.

Areas of Strategic Compulsions

Here is a list of some compulsions that a global business might have to face

- **E-commerce and Internet Culture** − Expansion of internet and information technology made the business move towards e-commerce. Online shopping /Selling and Advertising are important issues. These factors compel the businesses to go modern.
- **Hyperactive Competition** − Businesses now are hyper-competitive which compel them to draw a competitive strategy that includes general competitive intelligence to win the market share.
- **Diversification** − Uncertainty and operational risks have increased in the current global markets. Companies now need to protect themselves by diversifying their products and operations. Businesses now are compelled to focus on more than one business, or get specialized in one business.
- **Active Pressure Groups** − Contemporary pressure groups direct businesses to be more ethical in their operations. Most of the multinationals are now spending a good deal to address their Corporate Social Responsibility (CSR).

Standardization

- Standardization is the process of creating standards to guide the creation of a good or service based on the consensus of all the relevant parties in the industry.

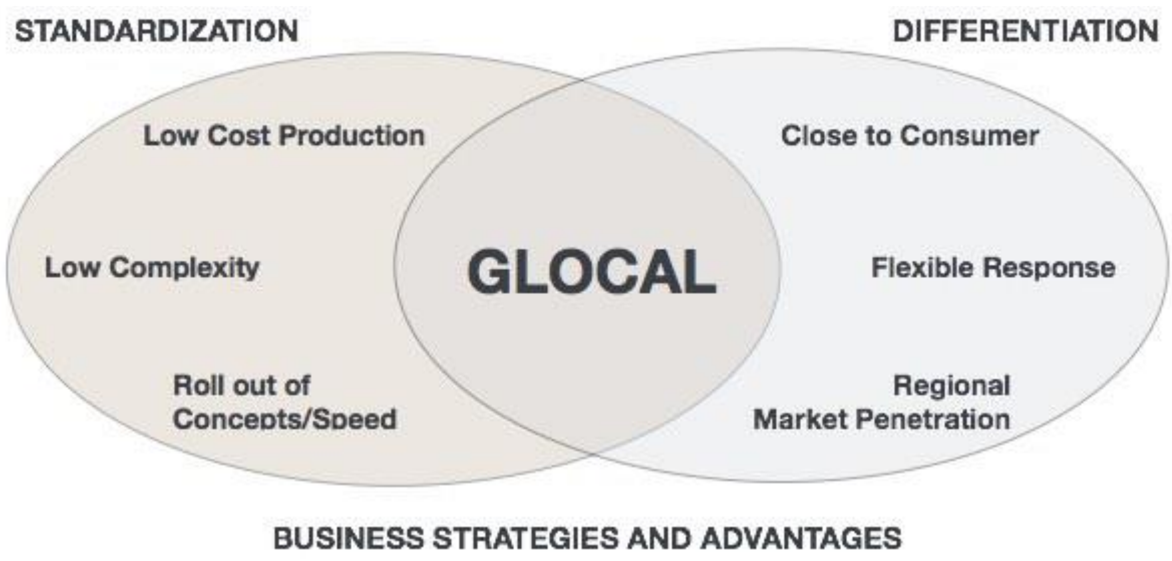
- The standards ensure that goods or services produced in a specific industry come with consistent quality and are equivalent to other comparable products or services in the same industry.
- Standardization also helps in ensuring the safety and compatibility of goods produced.
- Standardization can be found in business processes when companies require a consistent level of quality.
- For example, many fast food franchises have detailed processes documented to make sure that a burger is prepared in the same manner regardless of which establishment in its franchise a consumer visits.

Differentiation

- Differentiation is the strategy that aims to distinguish a product or service, from other similar products, offered by the competitors in the market.
- It entails development of a product or service, that is unique for the customers, in terms of product design, features, brand image, quality, or customer service.

Standardization Vs Differentiation

- Standardization and differentiation are the two sides of globalization.
- By standardization, we mean to show the global representation, while differentiation looks upon local competitiveness.
- The following figure depicts how standardization differs from differentiation.



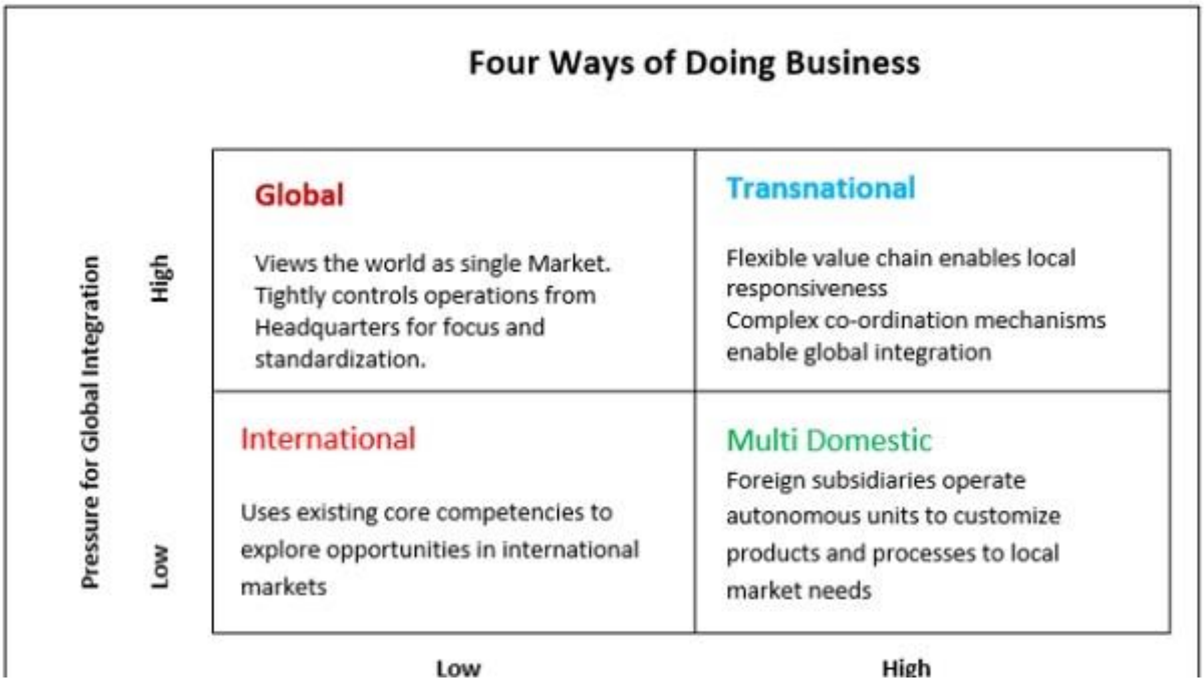
Factors favoring Standardization	Factors favoring differentiation
Economics of scale. In R&D, production and marketing.	Local environment-induced adaptation.., government and regulatory influences, legal issues.
Global competition	Local competition
Convergence of tastes and consumer needs(consumer preferences are homogeneous)	Variation in consumer needs(consumer needs are heterogeneous)
Centralized management of international operation.	Fragmented and decentralized management with independent country subsidies
A standardized concept is used by competitors	An adopted concept is used by competitors

Difference between Standardization vs Differentiation

Basis of Difference	Standardization	Differentiation
Application in marketing means	Companies should apply 4Ps in the Same way in World wide.	It is supported by strong market variety by Market individualism and uniqueness.
Reason for Application	Integration Access	Regional or local Conditions
Product Offered	Complete standardization	Altering relevant feature according to individual or geographic
Characteristics	Doesn't have special Characters	Product is differential from competitors product.
Approach	Increasing Commonality of product	Detailing the differentiation that exists between products and services
Economics of scale	Higher productivity and lowers the total cost	Increasing cost of production and lower productivity
Need	Satisfy the heterogeneous needs of the buyer	Satisfy a particular need of buyer
End Result	Benefits buyer by lowering price	Show sense of value to the buyer

Strategic Options

- Strategic Options include a set of strategies that helps a company in achieving its organizational goals.
- It is important to do a SWOT analysis of the internal environment and also the external environment to get the a list of possible strategic alternatives.
- A business can't run on gut feeling and hence, strategic options are indispensable tools for every international business manager.
- The following diagram shows the very basic options to choose – whether to go global or act local while improving the business in a holistic manner.



Pressure of National Responsiveness →

- **Global strategy:** It views the world as a single market. Tightly controls global operations from headquarters to preserve focus on standardization.
- **International strategy:** In this strategy company extends marketing, manufacturing and other activities outside the home country.
- **Multi-domestic strategy:** the international company discovers that differences in markets around the world demand an adaptation of its marketing mix in order to succeed.
- **Transactional strategy:** this is company that thinks globally and acts locally. The transactional corporation is much more than a company with sales, investments and operations in many countries.

Factors that Affect Strategic Options

There are many factors that need to be taken care of while choosing the best possible strategic options. The most influential ones are the following −

- **External Constraints** − The survival and prosperity of a business firm is fully dependent on interaction and communication with the elements that are intrinsic to the business. It includes the owners, customers, suppliers, competitors, government, and the stakeholders of the community.

- **Intra-organizational Forces −** The big decisions of a company are often influenced by the power-play among various interest groups. The strategic decision-making processes are no exception. It depends on the strategic choices made by the lower Management and top-notch strategic management people.
- **Values and Preferences towards Risk −** Values play a very important role, It has been observed that the successful managers have a more pragmatic, interactive and dynamic progressive and achievement seeking values. The risk takers in the high-growth less-stable markets prefer to be the pioneers or innovators. They seek an early entry into new, untapped markets.
- **Impact of Past Strategies −** A strategy made earlier may affect the current strategy too. Past strategies are the starting point of building up a new strategies.
- **Time Constraints −** There may be deadlines to be met. There may be a period of commitment, which would require a company to take immediate action.
- **Information Constraints −** The choice of a strategy depends heavily on the availability of information. A company can deal with uncertainty and risks depending on the availability of information at its disposal. Lesser the amount of information, greater the probability of risks.
- **Competitor's Risk −** It is important to weigh the strategic choices the competitors may have. A competitor who adopts a counter-strategy must be taken into account by the management. The likelihood of a competitor's strength to react and its probable impact will influence the strategic choices.

Global Portfolio Management

- It is also known as **International Portfolio Management** or **Foreign Portfolio Management.**
- Itrefers to grouping of investment assets from international or foreign markets rather than from the domestic ones.
- The asset grouping in GPM mainly focuses on securities.
- The most common examples of Global Portfolio Management are −
    i. Share purchase of a foreign company

ii. Buying bonds that are issued by a foreign government
iii. Acquiring assets in a foreign firm

Factors Affecting Global Portfolio Investment

Global Portfolio Management (GPM) requires an acute understanding of the market in which investment is to be made. The major financial factors of the foreign country are the factors affecting GPM. The following are the most important factors that influence GPM decisions.

- **Tax Rates :-** Tax rates on dividends and interest earned is a major influencer of GPM. Investors usually choose to invest in a country where the applied taxes on the interest earned or dividend acquired is low. Investors normally calculate the potential after-tax earnings they will secure from an investment made in foreign securities.
- **Interest Rates :-** High interest rates are always a big attraction for investors. Money usually flows to countries that have high interest rates. However, the local currencies must not weaken for long-term as well.
- **Exchange Rates :-** When investors invest in securities in an international country, their return is mostly affected by −

The apparent change in the value of the security.
The fluctuations in the value of currency in which security is managed.
Investors usually shift their investment when the value of currency in a nation they invest weakens more than anticipated.

Modes of Global Portfolio Management

Foreign securities or depository receipts can be bought directly from a particular country's stock exchange. Two concepts are important here which can be categorized as **Portfolio Equity** and **Portfolio Bonds**. These are supposed to be the best modes of GPM.

- **Portfolio Equity**

Portfolio equity includes net inflows from equity securities other than those recorded as direct investment and including shares, stocks, depository receipts (American or global), and direct purchases of shares in local stock markets by foreign investors.

- **Portfolio Bonds**

Bonds are normally medium to long-term investments. Investment in Portfolio Bond might be appropriate for you if −

You have additional funds to invest.

You seek income, growth potential, or a combination of the two.

You don't mind locking your investment for five years, ideally longer.

You are ready to take some risk with your money.

You are a taxpayer of basic, higher, or additional-rate category.

- **Global Mutual Funds**

Global mutual funds can be a preferred mode if the Investor wants to buy the shares of an internationally diversified mutual fund. In fact, it is helpful if there are open-ended mutual funds available for investment.

- **Closed-end Country Funds**

➢ Closed-end funds invest in internationals securities against the portfolio.
➢ This is helpful because the interest rates may be higher, making it more profitable to earn money in that particular country.
➢ It is an indirect way of investing in a global economy.
➢ However, in such investments, the investor does not have ample scope for reaping the benefits of diversification, because the systematic risks are not reducible to that extent.

Drawbacks of Global Portfolio Management

Global Portfolio Management has its share of drawbacks too. The most important ones are listed below.

- **Unfavourable Exchange Rate Movement −** Investors are unable to ignore the probability of exchange rate changes in a foreign country. This is beyond the control of the investors. These changes greatly influence the total value of foreign portfolio and the earnings from the investment. The weakening of currency reduces the value of securities as well.

- **Frictions in International Financial Market** − There may be various kinds of market frictions in a foreign economy. These frictions may result from Governmental control, changing tax laws, and explicit or implicit transaction costs. The fact is governments actively seek to administer international financial flows. To do this, they use different forms of control mechanisms such as taxes on international flows of FDI and applied restrictions on the outflow of funds.
- **Manipulation of Security Prices** − Government and powerful brokers can influence the security prices. Governments can heavily influence the prices by modifying their monetary and fiscal policies. Moreover, public sector institutions and banks swallow a big share of securities traded on stock exchanges.
- **Unequal Access to Information** − Wide cross-cultural differences may be a barrier to GPM. It is difficult to disseminate and acquire the information by the international investors beforehand. If information is tough to obtain, it is difficult to act rationally and in a prudent manner.

Instruments of Trade Policy

- Free trade refers to a situationswhere a government does not attempt to restrict what its citizens can buy from another country or what they can sell to another country.
- Trade policy is a collection of rules and regulation which pertain to trade.
- The purpose of trade policy is to help a nation's international trade run more smoothly, by setting clear standards and goals which can be understood by potential trading partners.
- There are 6 main instruments of Trade Policy:
    1. Tariffs
    2. Subsidies
    3. Import Quotas
    4. Voluntary Export Restrictions

5. Local Content Requirements
6. Administrative Policies

Tariffs

- A tariff is a duty or tax imposed by the government of a country upon the traded commodity as it crosses the national boundaries.
- Tariff can be levied both upon exports and imports.
- The tariff or duties imposed upon the goods originating in the home country and scheduled for abroad are called as the export duties.
- Countries, interested in maximising their exports generally avoid the use of export duties. Tariffs have, therefore, become synonymous with import duties.
- The import duties or import tariffs are levied upon the goods originating from abroad and scheduled for the home country. Sometimes a country may also resort to what is called as a transit duty. It is imposed upon the goods originating in the foreign country and scheduled for a third country crossing the borders of the home country. For instance, if India imposes tariffs on goods that Bangladesh exports to Nepal through the Indian Territory, these will be called as transit duties. Such duties are usually a matter of much concern for the land-locked countries.
- The imposition of import tariff results in the relative changes in prices of products and factors.
- That brings about a significant change in the structure of international trade. High tariffs certainly have the effect of restricting the volume of international trade. A negative tariff or subsidy is often supposed to expand foreign trade over and above its volume in the absence of subsidy.

Types of Tariffs

Tariffs are of several types and these can be classified into different groups or sub-groups as below:

(1) Classification on the Basis of Criterion for Imposition: These can be of such types as: (a) Specific tariff,

(b) Ad Valorem tariff,

a) Specific Tariff:

- Specific tariff is the fixed amount of money per physical unit or according to the weight or measurement of the commodity imported or exported. Such duties can be levied on goods like wheat, rice, fertilisers, cement, sugar, cloth etc. Specific duties are quite easy to administer, as they do not involve the evaluation of the goods.
- The determination of the value of the traded goods may be difficult as there are several variants of price such as demand price, supply price, market price, contract price, invoice price, c.i.f (cost, insurance, freight) price etc. The resort to specific duties enables the government to keep out of complexities of prices.
- However, the specific duties cannot be levied on high valued goods such as diamonds, jewellery, watches, T.V. sets, motor cars, works of arts like paintings etc. These articles can be taxed either on the basis of weight, surface area covered or the number of articles.

b) Ad Valorem Tariff:

- 'Ad Valorem' is the Latin word that means 'on the value.' When the duty is levied as a fixed percentage of the value of the traded commodity, it is called as valorem tariff. Such duties are levied on the products the value of which is disproportionately higher compared to their physical characteristics such as weight or measurement.
- These duties are more equitable as the costly goods, generally consumed by the rich, bear greater burden of duty, while the cheaper goods bought by the poor, bear lesser burden of tariff. For instance, if the import of watches is subject to 70 percent ad valorem tariff, a watch valued at Rs. 1000 will be subject to a duty of Rs. 700 and a watch valued at Rs. 1200 will be subject to a tariff amounting to Rs. 840. The ad valorem duties have an additional advantage that the international comparison of tariffs, in their case, can be easily made.

(c) Compound Tariff:

- The compound tariff is a combination of specific and ad valorem tariff. The structure of compound tariff includes specific duty on each unit of the commodity plus a percentage of ad valorem duty.

- The compound tariffs not only impart a greater elasticity to revenues but also assure a more effective protection to the home industries.

(d) Sliding Scale Tariff:

- The import duties which vary with the prices of the commodities are termed as sliding scale duties.
- These may either be on specific or ad valorem basis. In practice, these are generally on a specific basis.

(2) Classification on the Basis of Purpose for Which Tariff is Imposed:

On the basis of purpose of levying the tariff - These can be of two types:

(a) Revenue Tariff and

(b) Protective Tariff.

(a) Revenue Tariff:

- The tariff, which is imposed primarily for generating more revenues for the government is called as the revenue tariff. In advanced countries, the introduction and diversification of direct taxes has reduced the importance of tariff as a source of government revenues. But in the less developed countries, there is still much reliance of the governments on this source of revenue.
- Generally pure revenue tariff is not possible. The imposition of tariff, even for the purpose of securing revenues, does have protective effect when it leads to switch of demand by the domestic consumers from the imported to home- produced goods.

(b) Protective Tariff:

- The tariff may be imposed by the government to protect the home industries from the cut-throat competition from the foreign produced goods.
- The higher the tariff, greater may be the protective effect of tariff. A perfect protective tariff is likely to prohibit completely the import from abroad.

- In practice, the perfect protective tariff may not exist. If the domestic demand for import remains strong, there can be the possibility of smuggling imported goods. In addition, such a tariff will not yield any revenue to the government. A high rate of protective tariff can make the domestic producers more lethargic and inefficient and unable to face foreign competition even in the long run.

(3) Classification on the Basis of Discrimination:

- If the tariff is influenced by the consideration of discrimination.
- **There can be two types of tariffs-**
- (a) Non-discriminatory and
- (b) Discriminatory.

(a) Non-Discriminatory Tariff:

- If the uniform tariff rates are applicable to all the commodities irrespective of the country of origin, these are known as non-discriminatory tariffs. It is possible that low rates of tariffs on certain commodities exist because of commercial agreements with some countries but the tariff-imposing home country extends the same low tariff rates to the commodities of all the countries.
- Such a system of nondiscriminatory tariff is called as single column tariff. This system of tariff is easy and simple to administer. There is, however, one deficiency that it is not elastic enough to adjust according to the changing needs of the industries of the home country. From the viewpoint of revenues too, it may not be satisfactory for the tariff-imposing country.

(b) Discriminatory Tariff:

- In case of discriminatory tariff, the varying tariff rates exist for different commodities. The products originating from favoured countries are subject to a lower tariff rate than those of other countries. The discriminatory tariffs can be double or multiple column tariffs.
- In case of the double column tariff, two different rates of duty exist for all or some commodities. Both the rates are either announced by the government right from the beginning and the two rates come into existence after the country enters into

favoured-nation commercial agreement with some foreign countries. The favoured rates of tariff may either be on a unilateral basis or on a reciprocal basis.

(4) Classification on the Basis of Products:

Whether a product is imported or exported can be the basis of tariff -**On this basis, the tariffs can be of the types of:**

(a) Import duties and

(b) Exports duties

(a) Import Duties:

- If the home country imposes tariff upon the products of the foreign countries as they enter its territory, the tariff is known as import tariff or import duty.

(b) Export Duties:

- If the products of the home country become subject to tax as they leave its territory to be sold in the foreign market, the tax or duty is called as export tariff or export duty.
- The import tariffs have remained the matter of deep interest both for analytical and policy reasons. These are far more wide-spread, and almost every country takes resort to them. In contrast, the export duties are applied to a very limited extent. Some countries like the USA have prohibited export duties by law. Even in those countries, where these are in vogue, the basic purpose is to secure larger revenues.

Classification on the Basis of Retaliation:

On this basis, the tariffs can be of the types of

(a) Retaliatory tariffs and

(b) Countervailing tariffs.

(a) Retaliatory Tariffs:

- If a foreign country has imposed tariffs upon the exports from the home country and the latter imposes tariffs against the products of the former, the tariffs resorted to by the home country will be regarded as the retaliatory tariffs.
- The home country, while adopting this measure does not either has the object of raising revenues or protecting home industries but of acting in retaliation.

(b) Countervailing Tariffs:

- If the foreign country has been exporting large quantities of its products in the market of the home country on the strength of export subsidies, the home country can neutralise the 'unfair advantage' enjoyed by foreign products through imposing duties upon them as they enter the territory of the home country.
- The latter has full justification for resorting to these countervailing duties in order that the unfair advantage given by exports subsidies to the foreign products is offset and the competition takes place on equal footing between the foreign and home produced goods.

Profits of Imposing Tariffs

- Beneficial to the govt. as it raises revenue.
- Beneficial to the home producers as they get a market for their product.
- Beneficial for the growth of the domestic country.
- Restricts imports.
- Encourages exports.
- Domestic production goes up.
- Domestic price goes up.

Effects of Tariffs on different segments

- On Producers – Producers gain due to tariff. Their area of production increases due to non-penetration of foreign producers. Domestic production and domestic prices go up.
- On Government – Govt. collects revenues by imposing tariff so it gains from it.
- On Consumers – Loss for consumer as they have to pay for more imports.

1. Subsidies

A subsidy is a government payment to a domestic producer. Subsidies take many forms including cash grants, low interest, tax breaks and government equity participation in domestic and government producers in two ways:

i) They help producers compete against foreign imports and

ii) Subsidies help them gain export markets.

The main gains from subsidies accrue to domestic producers, whose international competitiveness is increased as a result of them.

Export Subsidies

- Export subsidy is a government policy to encourage export of goods and discourage sale of goods in the domestic market through direct payments, low-cost loans, tax relief for exporters, or government-financed international advertising.
- An export subsidy reduces the price paid by foreign importers, which means domestic consumers pay more than foreign consumers.
- The WTO prohibits most subsidies directly linked to the volume of exports. Incentives are given by the government of a country to exporters to encourage export of goods.

Advantages of Subsidy

- **Lowering prices and controlling inflation -** They are especially applicable in the area of fuel prices, particularly when global crude oil prices are rising. Many countries subsidize fuel costs in order to keep prices from ballooning.
- **Preventing the long-term decline of industries -** There are many industries that should be kept alive and functional, such as fishing and farming. Many new and fast-growing industries may also benefit from being subsidized.
- **A greater supply of goods -** Governments want to increase the access of their population to Goods & Services such as Water, Food, and Education. They, therefore, provide an incentive that could be in the form of a tax credit or even straight up cash.

Disadvantages of Subsidy

- **Shortage of supply -** Though one of the advantages of subsidies is the greater supply of goods, a shortage of supply can also occur. This is because lowered prices can lead to a sudden rise in demand that many producers may find very hard to meet. Ultimately, it can lead to very high demand that causes an increase in prices.
- **Difficulty in measuring success -** Subsidies are usually effective and helpful. However, if the government were to make a report of its success in using subsidies, it would be a different story. This is because it is hard to quantify the success of subsidies.
- **Higher taxes -** How will the government raise funds to use for subsidizing industries? Of course, by imposing higher taxes. So, it is the people who provide the means to enable the government to subsidize industries.

2. Import Quota

Direct restriction on the quantity of some goods that may be imported into a country. An import quotas: Limitations on the quantity of goods that can be imported into the country during a specified period of time.

Reasons for Imposition of quotas

i) Insurance against further increase in import competition.

ii) If world price drops, the amount imported is the same in case of quotas.

iii) Greater administrative power and flexibility.

Types of Quota

- **Under tariff quota** – Import of a commodity is allowed to enter the country at an especially low rate of duty (or free duty). In case the volume of import goes above the specified volume, the import duty is levied.
- **Unilateral quota** – Only one country specifies a limit on the quantity of commodity to be imported during a stipulated or a specific period.

- **Bilateral quota** – It is fixed through negotiation between the importing country and the exporting country.
- **Mixing quota** – Various countries have regulations regarding utilization of a certain proportion of domestic raw materials in the production of specified finished products.
- **Import Licensing** – In this method an even distribution of quotas between different suppliers is ensured without disrupting the market.

Effects of Quota

- Reduces the quantity of imports
- Helps maintain a fair price for the commodity
- Drives the domestic price above the world price

3. Voluntary Export Restrictions (VERs)

These are quotas on trade imposed by the exporting country, typically at the request of the importing country's government.Typically VERs arise when the import-competing industries seek protection from a surge of imports from particular exporting countries. VERs are then offered by the exporter to appease the importing country and to avoid the effects of possible trade restraints on the part of the importer. Ex: one of the most famous examples is the limitation on auto exports to the United States enforced by Japanese automobile producer in 1981. Foreign producers agree to VERs because they fear for more damaging punitive tariffs or import quotas might follow if they do not.

Benefits: Limit competition.

Sufferers: VER always raises the domestic price of an imported goods, so VER do not benefit consumers.

4. Local Content Requirements

A local content requirement demands that some specific fraction of a good be produced domestically. In Physical terms (e.g., 75 percent of component parts for this product must be produced locally) . In Value terms (e.g., 75 percent of this product must be produced locally). Initially used by developing countries to help shift from assembly to production of goods. Developed countries (US) beginning to implement.For component parts manufacturer, LC Regulations acts the same as an import quota. It benefits producers, not consumers.

5. Administrative Policies

Sometimes government uses a range of informal or administrative policies to restrict imports and boost exports.These policies are bureaucratic rules designed to make it difficult for imports to enter a country. For example –

i) In Japan, custom inspectors insisted on checking every tulip bulb from Netherlands by cutting it vertically down the middle

ii) France required all imported videotape recorders arrive through a small customs entry point which delayed Japanese VCRs

Dumping

Dumpling is defined as selling goods in a foreign market below production costs or selling goods in a foreign market below fair market value. Dumpling is result of unloading excess production in foreign markets.This is a predatory behavior of producers who gain substantial profits from their home markets and try to subsidize prices in a foreign market with a view to driving indigenous competitors out of that market. The predatory firm can raise prices and earn substantial profits.

Antidumping policies are policies designed to punish foreign firms that engage in dumping. The ultimate objective is to protect domestic producers from "unfair" foreign competition.Since these practices are naturally considered to be unfair competition by manufacturers in the country in which the goods are being dumped, the government of the foreign country will be asked to impose "anti-dumping" duties .

Countervailing duties

Such duties are similar to anti-dumping but are not so severe. These duties are imposed to nullify the benefits offered through cash assistance or subsidies by the foreign country to its manufacturers. The purpose of the duty is to offset, or "countervail" the subsidy so that the goods cannot be sold at an artificially low price in the foreign country and thereby provide unfair competition for local manufacturers.

Government Intervention

There are 2 kinds of arguments:

- Political arguments: To protect the interests of certain groups within a nation (normally producers), and often at the expense of other groups (normally consumers)
- Economic arguments: boost the overall weath of a nation (to all benefit of all, both producers and consumers)

Political arguments

1) **Protecting jobs and industries**: is the most common political argument for government intervention. It is needed to protect jobs and industries from more efficient foreign producers.
2) **National security**: Government protects some certain industries because they are important for national security (defense- related industries: aerospace, advanced electronics or semiconductors).
3) **Retaliation**: Government should use the threat to intervene in trade policy as a bargaining tool to help open foreign markets and force trading partners to "play by the rule of the games". however, it is a risky strategy.
4) **Protecting consumers:**Many governments have had regulations to protect consumers from unsafe products (e.x: limiting or banning the import of certain products).
5) **Furthering Foreign policy objectives**: Trade policy can be used to support foreign policy objectives. - Preferential trade terms can be granted to countries that a government wants to build strong relation with. Trade policy may be used to punish rogue states that do not abide by international laws or norms. Note that other countries can undermine unilateral trade sanctions (e.g US sanctions against Cuba have not stopped other Western countries from trading with Cuba).

6) **Protecting human rights**: government can use trade policy to improve the human rights policies of trading partners. The best way to change the internal human rights of a country is to engage it in international trade (growing bilateral trade raises the income level of both countries, people begin to demand and general receive better treatment with regard to their human rights)

Economic arguments

- **The Infant industry argument:** This states that a new industry in developing countries should be temporarily supported (with tariffs, import quotas, subsidies) until they have grown strong enough to meet international competition. However, this argument has been criticized because it is useless unless it makes the industry more efficient. If a country has potential comparative advantages, firms should be capable of raising necessary funds without additional support from the government.

- **Strategic trade policy**: Under this the government can help raise national income if it can somehow ensure that the firm to gain first-mover advantage in such an industry are domestic rather than foreign enterprises.Government can help firms overcome barriers to enter industries where foreign firms have an initial advantage.

ABIT

INTERNATIONAL BUSINESS (MBA 206)

International Strategic Management (Module-3)

Mitrabinda Nayak

Organizational Structures

Designing of organizational structure is based on organizational analysis which involves the following aspects:

1) **External Environment**: All the external factors like economic, political, legal, technological and social factors are taken into consideration.

2) **Overall aims and purpose of the enterprise**: One has to decide what the core aims and objectives of the organization are – survival, growth, wealth maximization and profit maximization.

3) **Activities**: All the activities of the organization are analysed and checked whether they are aligned to the organizational objectives or not.

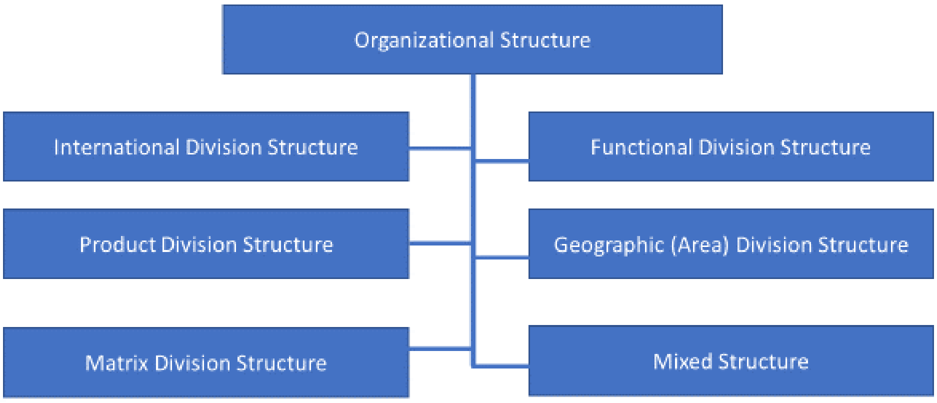
4) **Decisions**: Both the dimensions – vertical & horizontal decisions are used for decision making.

5) **Job Structure**: It is also analysed under organizational analysis. It involves analysing job design, job specification, job description etc.

6) **Organizational Climate**: It refers to the working environment of an enterprise where an employees work.

7) **Management Style**: It involves various styles of management such as benevolent– autocratic, democratic and laissez faire.

A multinational enterprise can adopt various types of organizational structures in its international business. These are as follows:



A) International Division Structures

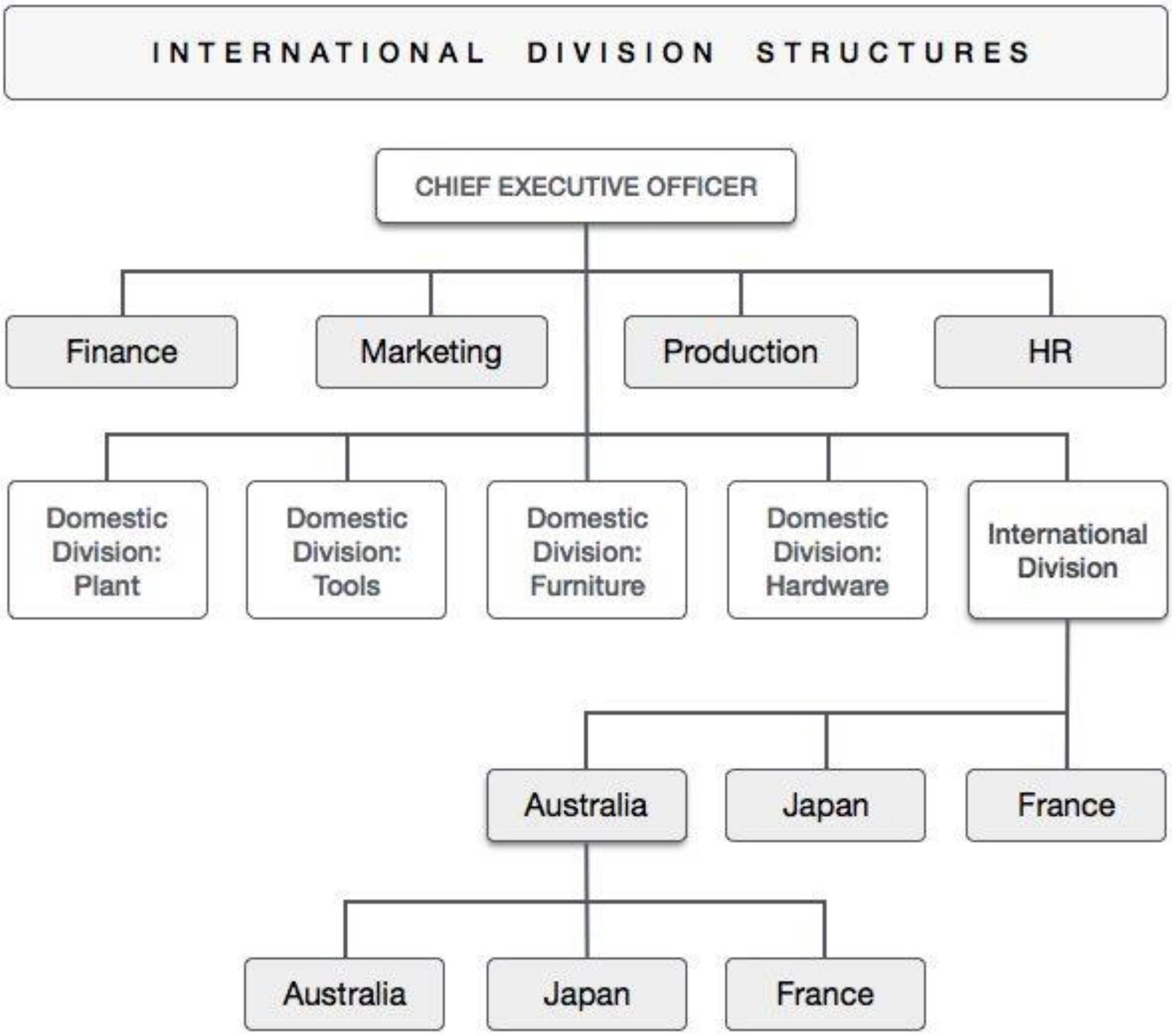
This structure is built to handle all international operations by a division created for control. It is often adopted by firms that are still in the development stages of international business operations.

Advantages

- International attitude gets the attention of top management
- United approach to international operations

Disadvantages

- Separates domestic managers from their international counterparts
- Difficulty in ideating and acting strategically and in allocating resources globally



B) Product Division Structure

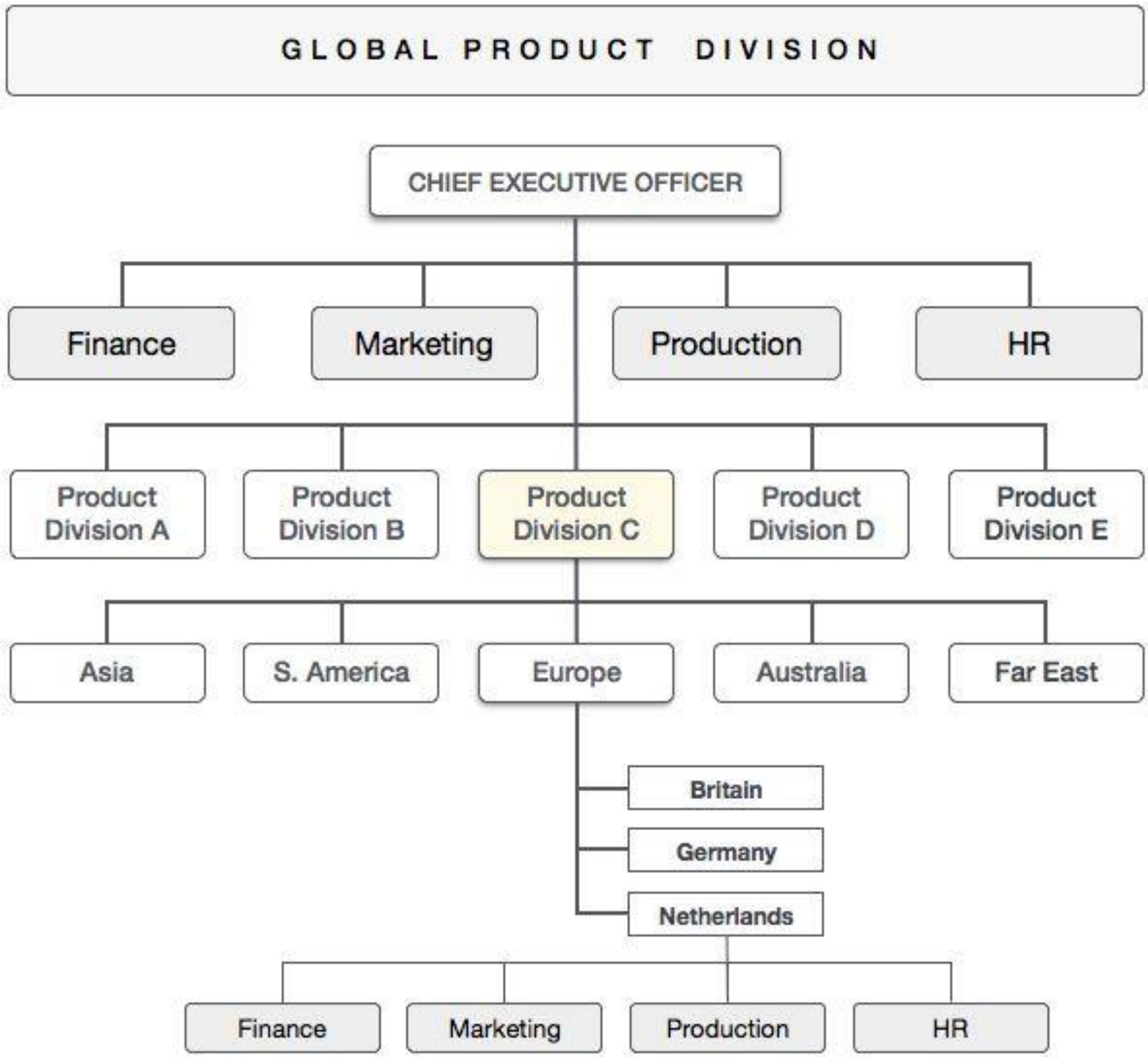
Product divisions include domestic divisions that are allowed to take global responsibility for product groups. These divisions operate as profit centers.

Advantages

- Helps manage product, technology, customer diversity
- Ability to cater to local needs
- Marketing, production, and finance gets a coordinated approach on a product-by-product, global basis

Disadvantages

- Duplication of facilities and staff personnel within divisions
- Division manager gets attracted to geographic prospects and neglects long-term goals
- Division managers spending huge to tap local, not international markets



C) Geographic (Area) Division Structure:

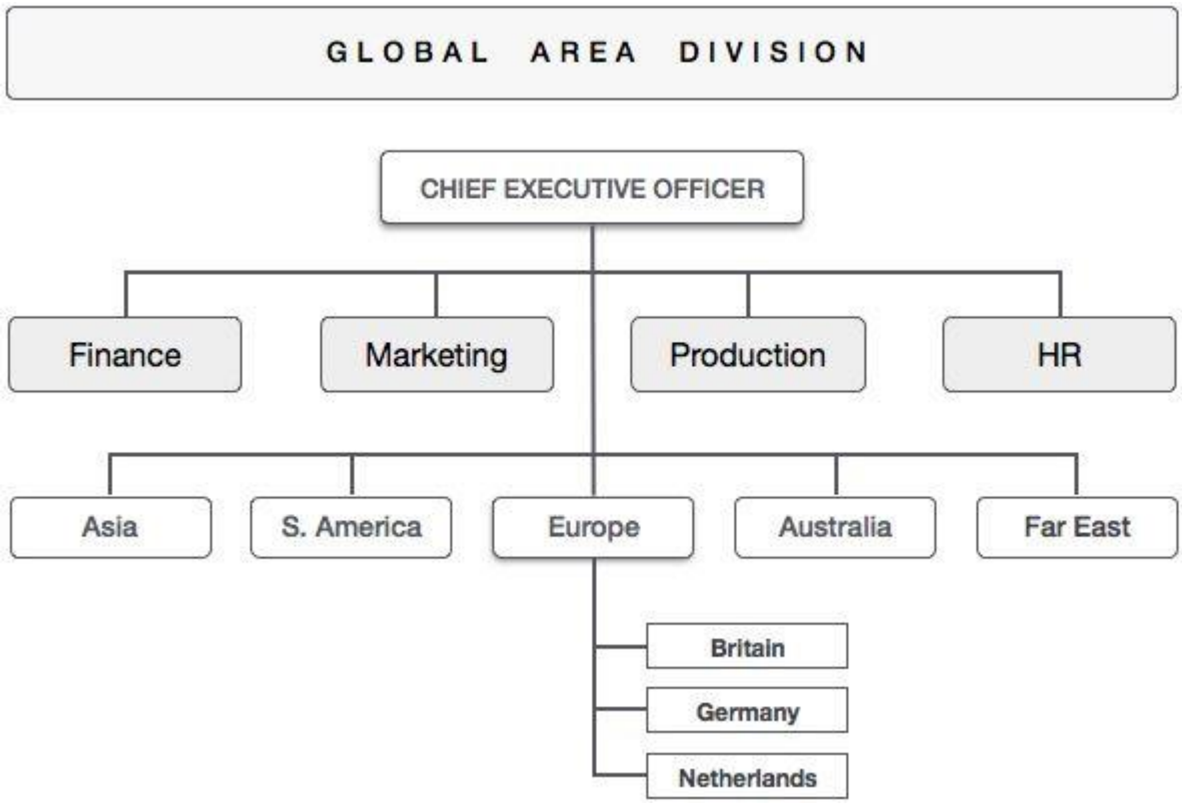
Global area division structure is used for operations that are controlled on a geographic rather than a product basis. Firms in mature businesses with select product lines use it.

Advantages

- International operations and domestic operations remain at the same level
- Global division managers manage business operations in selected geographic area
- Ability to reduce cost per unit and price competitively

Disadvantages

- Difficult to align product emphasis in a geographically oriented manner.
- New R&D efforts are often ignored, as sale in mature market is where the focus is.



D) Functional Division Structure:

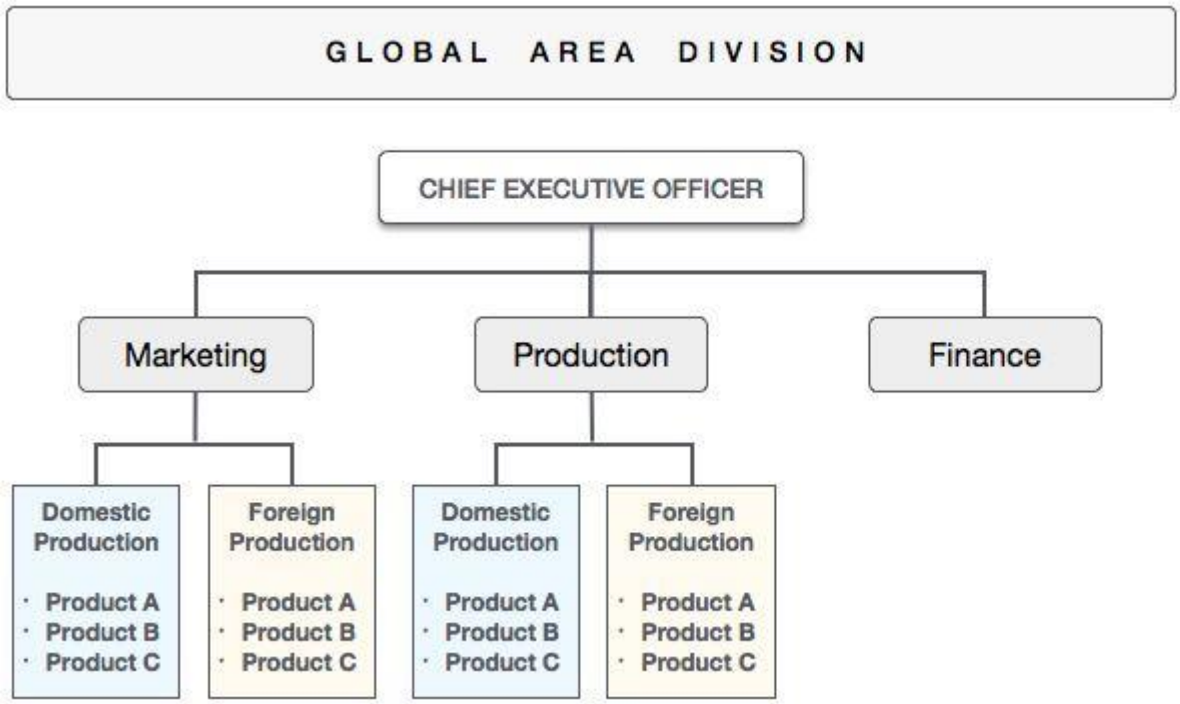
This structure is to primarily organize global operations based on function; product orientation is secondary for firms using global function division structure.

Advantages

- It emphasizes on functional leadership, centralized-control, and leaner managerial staff
- Favorable for firms that require a tight, centralized coordination and control over integrated production mechanisms
- Helps those firms that need to transport products and raw materials between geographic areas

Disadvantages

- Not suitable for all types of businesses. Applicable to only oil and mining firms
- Difficult to coordinate manufacturing and marketing processes
- Managing multiple product lines can be challenging, as production and marketing are not integrated.



E) Matrix Division Structure

This structure combines product, area, and functional arrangements and it has a cross-cutting committee structure.

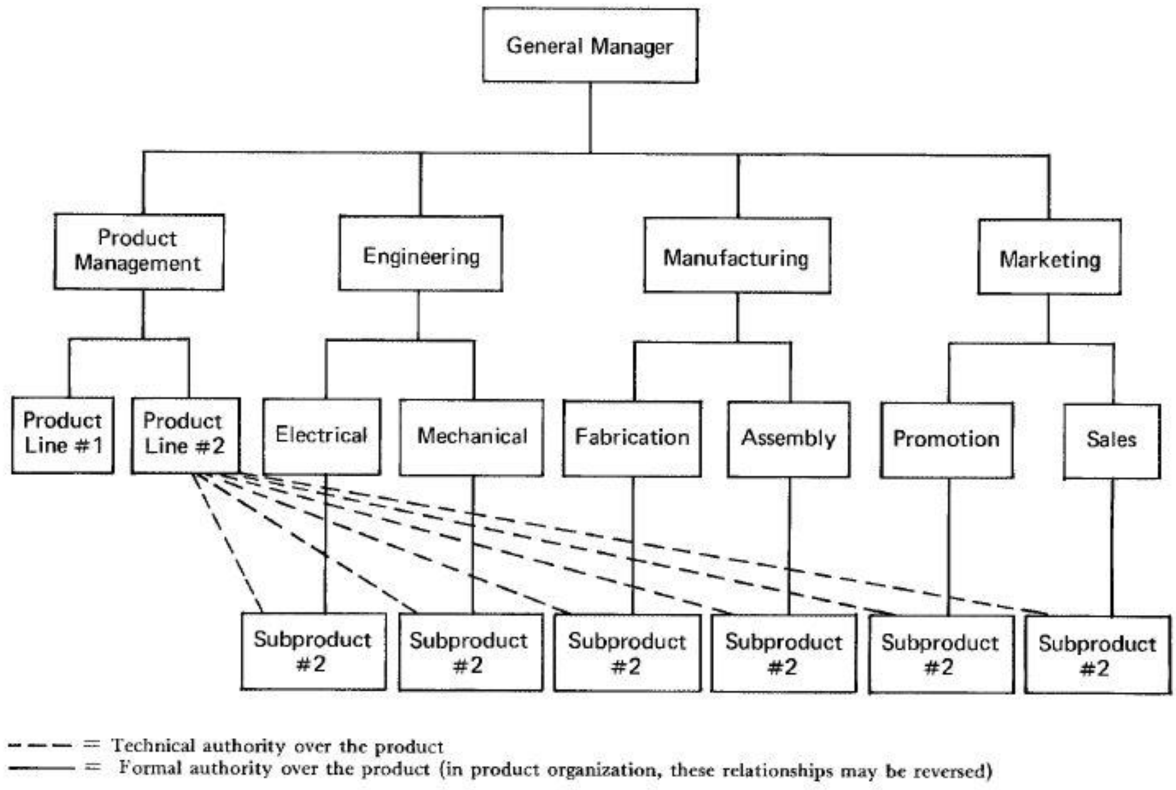
Advantages

- Can be designed to meet individual needs
- Promotes an integrated strategic approach tailored to local needs and priorities

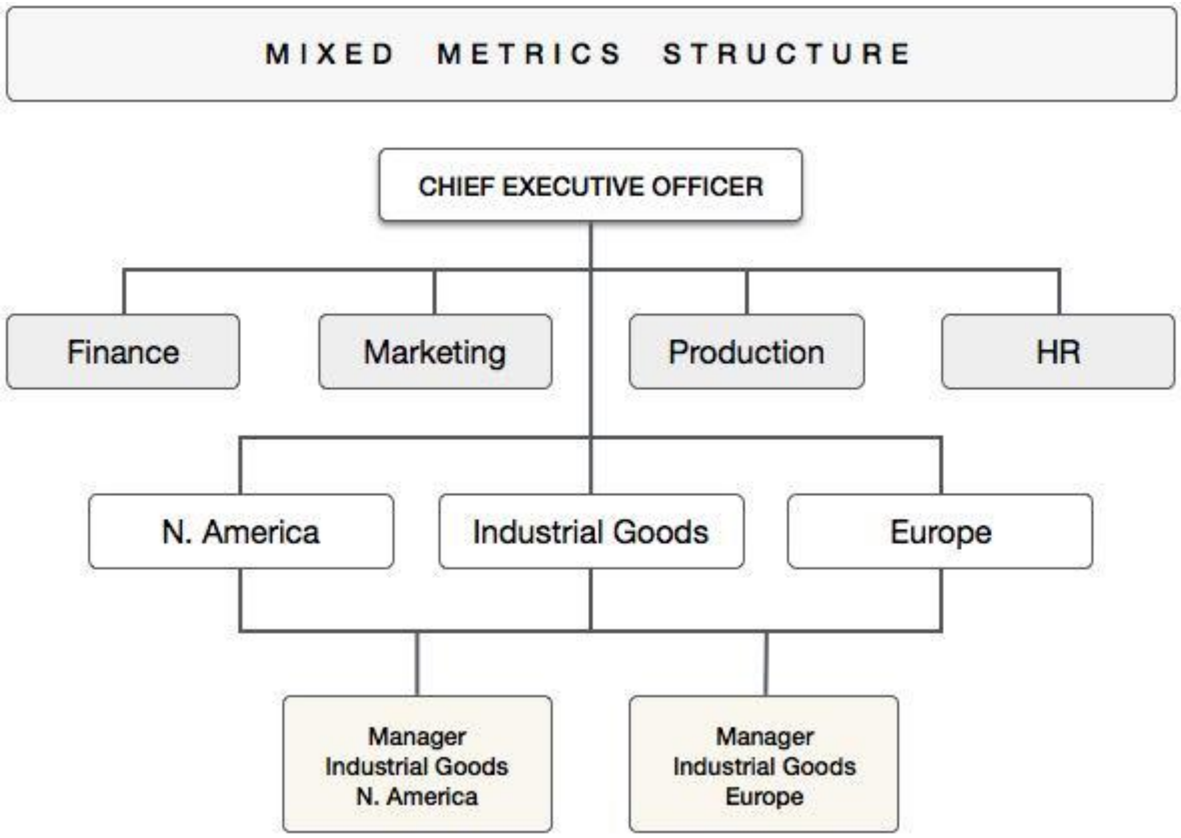
Disadvantages

- Complex structure, coordinating and getting everyone to work toward common goals becomes difficult.
- Too many independent groups in the structure

Standard's Pure Matrix Organization



F) Mixed Structure



Factors influencing International Organizational Structure

There are two types of factors which influence international organizational structure. They are internal factors and external factors.

Internal Factors: The following internal factors affect the organization structure.

i) **Management Structure** – The management orientation which can be ethnocentric (the parent company has strong control over its subsidiaries, centralized decision making), geocentric (structure is multicultural with centralized decision making) or polycentric (decentralized decision making and authority).

ii) **Organization size**–An increase in the intake of employees to support the higher management in running the organization adds to more levels and complexity of the organization. Growth in size also necessitates decentralization.

iii) **Employee strength** – Increase in the no. of employees leads to more formalization and setting up for policies and procedures to control the employees.

External Factors: The following external factors affect the organization structure.

i) **Environmental Uncertainty** – In today's dynamic business scenario there is always some degree of uncertainty in the external environment. Use of lateral communication channels, presence of few rules & regulations, flexible rules and regulations help in dealing with uncertain external environment.

ii) **Differentiation and Integration** – Differentiation is dividing the organization into different departments. These departments are dependent on the external environment. When different departments of the organization co-ordinate their efforts it is referred to as integration. Here there is a strong connection between its departments and its product lines.

iii) **Technology**–Use of technology is present at all stages be the input, process and output of the organization.

Organizational Issues of International Business

The various problems faced by international businesses in terms of organizational issues are as follows:

1) Centralization VS Decentralization

Each global organization faces the dilemma of deciding the level of power that is to be given to the subsidiaries. Under decentralization, managers of the subsidiaries fulfil the needs of the host country. At times, the interests of the global organization may be compromised. But under centralization, the parent company safeguards its own interests. However prompt decision making in response to local market situations for host countries can be challenging. Most MNCS use a mixture of both centralization and decentralization to attain their objectives.

2) Use of Subsidiary Board of Directors

Subsidiaries of MNCs, mostly fully owned have board of directors to monitor the top level managers and their actions. The issue here is how much power to vest in these bodies. Should these be just a formality or should the board of directors be allocated with significant decision-making authority.

3) Non- traditional Organizational Arrangements

There are many issues which arise out of mergers and acquisitions and joint ventures. Traditional hierarchical treatment cannot be used in these cases. Hence companies deploy different methods to deals with such situations.

4) Role of Information Technology

The use of IT has been a key to gaining competitive advantage. The use of information technology not only allows businesses to respond quickly but also lowers administrative costs and also helps in production of different products.

5) Culture in International Business

The cohesive force that binds the different subsidiaries of a MNC is its culture. The importance of culture can be denied in organizations which are into international business.

6) Managing Change in International Business

Change is the only constant, and this is so true for businesses. An organization must be always ready to face different changes in the business environment. It should be capable of formulating suitable strategies as per the need of the hour. Flexibility is the key to change.

Controlling of international business

Control mechanisms play an important role in any business organization, without which the roles of managers get constrained. Control is required for achieving the goals in a predefined manner because it provides the instruments which influence the performance and decision-making process of an organization.

Definition – “Control is in fact concerned with the regulations applied to the activities within an organization to attain expected results in establishing policies, plans, and practices.”

Control mechanisms can be set according to functions, product attributes, geographical attributes, and the overall strategic and financial objectives.

Objectives of Control

There are three major objectives for having a control mechanism in an international firm. They are −

- To get data and clues for the top management for monitoring, evaluating, and adjusting their decisions and operational objectives.
- To get clues based on which common objectives can be set to get optimum coordination among units.
- To evaluate the performance metrics of managers at each level.

Approaches to Control Mechanisms

There are seven major approaches for controlling a business organization. These are discussed below −

1. Market Approach

The market approach says that the external market forces shape the control mechanism and the behavior of the management within the organizational units of an MNC. Market approach is applied in any organization having a decentralized culture. In such organizations, transfer prices are negotiated openly and freely. The decision-making process in this approach is largely directed and governed by the market forces.

2. Rules Approach

The rules approach applies to a rules-oriented organization where a greater part of decision-making is applied to strongly impose the organizational rules and procedures. It requires highly developed plan and budget systems with extensive formal reporting. Rules approach of control utilizes both the input and output controls in an organized and exclusively formalized manner.

3. Corporate Culture Approach

In organizations that follow the corporate culture approach, the employees internalize the goals by building a strong set of values. This value-syndication influences the operational mechanism of the organization. It has been observed that even when some organizations have strong norms of behavioural controls, they are informal and less explicit. Corporate culture approach requires more time to bring the aimed changes or adjustments in an organization.

4. Reporting Culture

Reporting culture is a powerful control mechanism. It is used while allocating resources or while the top management wants to monitor the performance of the firm and the employees. Rewarding the personnel is a common practice in such approaches of control. However, to get the maximum out of reporting approach, the reports must be frequent, correct, and useful.

5. Visits to Subsidiaries

Visiting the subsidiaries is a common control approach. The disadvantage is that all the information cannot be exchanged via visits. Corporate staff usually and frequently visit subsidiaries to confer and socialize with the local management. Visits can enable the visitors to collect information about the firm which allows them to offer advice and directives.

6. Management Performance Evaluation

Management performance Evaluation is used to evaluate the subsidiary managers for the subsidiary’s performance. However, as decision-making authority is different from the operational managers, some aspects of control cannot be managed via this approach. Slow growth rates of firms and risky economical and political environment requires this kind of approach.

7. Cost and Accounting Comparisons

Cost and Accounting Comparisons is a financial approach. It arises due to the difference in expenditure among various units of the subsidiaries. A meaningful comparison of the operating performances of the units is necessary to get the full output from this approach. Cost accounting comparisons use a set of rules that are applicable to the home country principles to meet local reporting requirements.

Types of Control Mechanisms

There are various modes of control. The most influential ones are the following −

1. Personal Controls

Personal controls are achieved via personal contact with the subordinates. It is the most widely used type of control mechanism in small firms for providing direct supervision of operational and employee management. Personal control is used to construct relationship processes between managers at different levels of employees in multinational companies. CEOs of international firms may use a set of personal control policies to influence the behavior of the subordinates.

2. Bureaucratic Controls

These are associated with the inherent bureaucracy in an international firm. This control mechanism is composed of some system of rules and procedure to direct and influence the actions of sub-units.

The most common example of bureaucratic control is found in case of **capital spending rules** that require top management's approval when it exceeds a certain limit.

3. Output Controls

Output Controls are used to set goals for the subsidiaries to achieve the targeted outputs in various departments. Output control is an important part of international business management because a company's efficiency is relative to bureaucratic control.

The major criteria for judging output controls include productivity, profitability, growth, market share, and quality of products.

4. Cultural Controls

Corporate culture is a key for deriving maximum output and profitability and hence cultural control is a very important attribute to measure the overall efficiency of a firm. It takes form when employees of the firm try to adopt the norms and values preached by the firm.

Employees usually tend to control their own behavior following the cultural control norms of the firm. Hence, it reduces the dependence on direct supervision when applied well. In a firm with a strong culture, self-control flourishes automatically, which in turn reduces the need for other types of control mechanisms.

Steps in Controlling International Business Operations

The steps involved are:

1) **Establishment of standards**–The structure of the control process depends on establishment of standards. These need to be understood and accepted at all levels.
2) **Measurement of Performance**– After standards are set, a suitable system for monitoring and comparing the actual performance against set standards needs to be incorporated. This can be done through reports, meetings, special measurement techniques distribution cost analysis, marketing audit etc.
3) **Evaluation of Performance**– The main objective of evaluating the performance of a subsidiary is to take corrective actions if there are deviations from the set standards.
4) **Taking Corrective Actions**–After comparison of actual performance with planned performance is done and deviations found then corrective actions need to be undertaken like changes in operations and procedures, altering the existing standards and objectives etc.

Constraints of Control Approaches

Control mechanisms can never be uniform in every country. International firms have to face severe constraints based on which they modify their control mechanisms in every country. Here is a list of major constraints that affect an organization in setting its managerial control mechanism −

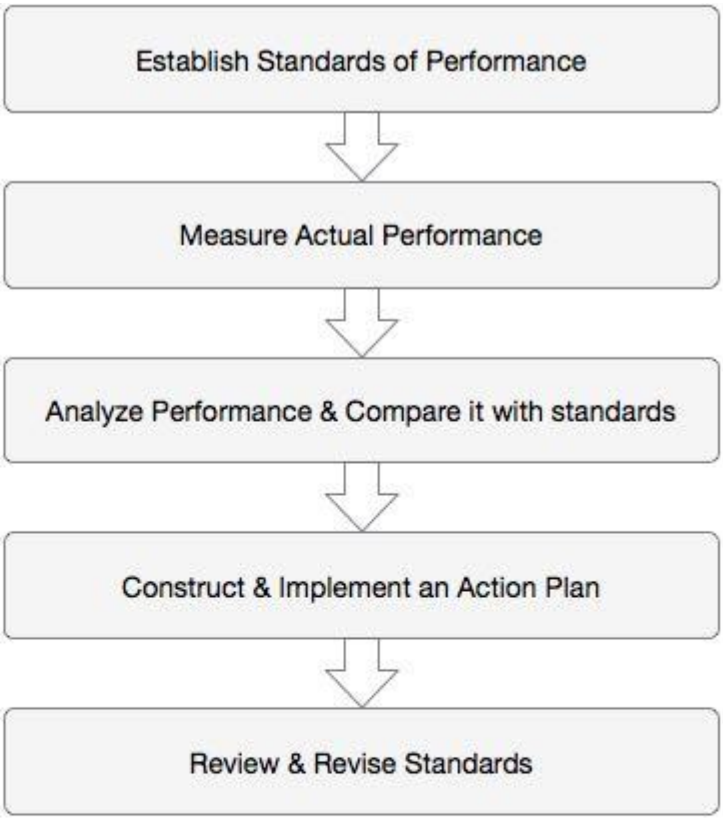
- **Distance** − Geographical distances and various forms of cultural disparities is a big constraint of control systems. Nowadays, email and fax transmissions have replaced the human communication, changing the meaning of distance among units and employees of an organization.
- **Diversity** − It is hard to apply a common control system to everyone due to diversity. It requires the managers to be locally responsive to address the needs of the country in which the firm operates. Diverse attributes may exist in the form of labour, cost, currency, economic factors, business standards, etc.
- **Degree of Uncertainty** − Data relating to the reporting mechanism may be inaccurate and incomplete, raising serious challenges to control mechanisms. Due to uncertainties, control mechanisms must focus on setting goals and developing plans to meet the goals.

Performance of evaluation system

It is an important part of every business organization to measure the performance of both employees and the firm as a whole. We will, however, restrict our focus on organizational performance measurement.

Performance evaluation can be defined as “the periodic review of operations to ensure that the objectives of the enterprise are being accomplished.

The standard process of measuring the performance of a global business is as shown in the following diagram −



The prominent features of each stage are discussed below.

1. **Establish Standard of Performance -** Standard of performance is applicable to cost, quality, and customer service. More than one standard may be necessary because they reflect expected levels of various units of the manufacturing performance. This includes process yields, product quality, overhead spending levels, etc.

2. **Measure Actual Performance -**To measure actual performance, the use of automated data collection systems is suggested to gather information. A standard cost measurement system includes man-hours, machine-hours, and material usage.

3. **Analyze the Performance and Compare it with standards -**There must be some set standards to compare the actual performance. The standards should be realistic and achievable. The results of the comparison can be used to apply further rules, targets, and reporting.

4. **Construct and Implement an Action Plan -**Constructing and implementing an action plan is key to success. **Variance analysis** can be used to detect potential problem areas. Finding the source of the problem and improving the situation may

be useful. Its effectiveness depends on the management's adaptability to the information obtained.

5. **Review and Revise Standards -**Review and revise is an important step, as modern organizations are in a constant state of change. If the variances are significant, the performance standards can be adjusted. Effective Performance Measurement must be integrated with the overall strategy. This step requires various financial and non-financial indicators.

Performance Management Indicators of an MNC

1. **ROI (Return on Investment)** − ROI is the most common method to evaluate the performance of an international firm. It shows the relationship between profit to invested capital and encompasses almost all important factors related to performance. An improved ROI can act as a logical motivator of the managers.

2. **Budget as Success Indicator** − Budget is an accepted tool for measuring and controlling the operations. It is also used to forecast future operations. A budget is a clearly expressed set of objectives that guide the managers to set their individual performance standards. A good local or regional budget helps the company to facilitate its strategic planning process smoothly.

3. **Non-Financial Measures** − The major non-financial measures that can be used to evaluate performance are − Market Share, Exchange Variations, Quality Control, Productivity Improvement, and Percentage of Sales.

Types of Performance Evaluation Systems

Performance evaluation systems can be of the following types −

- **Budget Programming** − Budget programming is prepared for operational planning and financial control. It is an easy-to-calculate system to evaluate the variance. It is used to measure the current performance in relation to some comparable performance metric from the past.
- **Management Audit** − It is an extended form of financial audit system which monitors the quality of management decisions in financial operations. It is used for appraisal and performing audit for management.

- **Programme Evaluation Review Technique (PERT)** − Based on CPM, PERT delineates a given project or program into network of activities or sub-activities. The goal is to optimize the time spent by the managers. In this process, performance is measured by comparing the scheduled time and the cost allocated with the actual time and the cost.
- **Management Information System (MIS)** − MIS is an ongoing system designed to plan, monitor, control, appraise, and redirect the management towards pre-defined targets and goals. It is a universally acceptable practice which encompasses the financial, budgeting, audit and control systems of the PERT.

Problems of Performance Evaluation in MNCs

1. **Transfer Pricing**–Goods and services of the global organization are transferred from the parent company to the subsidiaries, from one subsidiary to another subsidiary and even from subsidiaries to parent company. The pricing used for these goods and services is known as transfer pricing. This leads to problems in actual performance evaluation of the global organization and its subsidiaries.
2. **Foreign currencies**–The local currency of the subsidiary is used during accounting. This however needs to be translated into the currency of the parent company for proper evaluation.
3. **Inflation** – Under inflation the accounting statement are rendered useless and its is not possible to measure performance.
4. **Effect of environmental factors** – The performance of the subsidiary depends on many environment factors which could be economic, political, legal, cultural etc. The effect of these need to be adjusted or eliminated before evaluating performance.

Global Production

Production is the core of any business organization having its operations on an international scale. International business firms must look closely at production factors for profitability and sustainability. Production refers to manufacturing, acquiring, and developing products for the business market.

Factors that Affect Production

There are three major areas an international organization must focus on in order to increase its production efficiency. They are −

- Location
- Scale of Operation
- Cost of Production

1. Location

The location of the facility refers to the appropriate location for the manufacturing facility; it should have optimum access to customers, workers, transportation, etc.The main goal of an organization is to satisfy and delight customers with its product and services. The manufacturing unit plays a major role in this direction. One of the most important factors for determining the success of a manufacturing unit is its location.To get commercial success and retain its competitive advantage, any international business firm would pay attention to the following critical factors while choosing its business location:-

- **Customer Proximity** − Customer proximity is important to reduce transportation cost and time.
- **Business Area** − Having other manufacturing units of similar products around the business area is conducive for facility establishment.
- **Availability of Skilled labour** − There should be skilled labour available in and around the facility location.
- **Free Trade Zone** − Free-trade zones usually promote and augment the establishment of manufacturing facility by offering incentives in custom duties and applicable levies.
- **Suppliers** − Continuous availability and quality supply of the raw materials influences in determining the location of production facility.
- **Environmental Policy** − As pollution control is very important, understanding of environmental policy for the facility location is critical.

There are two basic strategies for locating manufacturing facilities:

i) Concentrating them in a centralized location and serving the world market from there, or

ii) Decentralizing them in various regional or national locations that are close to the major markets

The appropriate strategic choice is determined by the various country-specific, technological and product factors which is summarised in a table as below:

	Concentrated Production Forward	**Decentralized Production Favoured**
A) Country Factors		
1) Differences in political economy	Substantial	Few
2) Differences in culture	Substantial	Few
3) Differences in factor costs	Substantial	Few
4) Trade Barriers	Substantial	Few
5) Location externalities	Important in industry	Not important in industry
6) Exchange Rates	Stable	Volatile
B) Technological Factors		
1) Fixed Costs	High	Low
2) Minimum Efficient Scale	High	Low
3) Flexible Manufacturing Technology	Available	Not available
C) Product Factors		
1) Value-to-weight ratio	High	Low
2) Serves universal needs	Yes	No

Therefore, concentration of production makes sense when:

i) Differences between countries in factor cost, political economy and culture have a substantial impact on the costs of manufacturing in various countries.

ii) Trade barriers are low

iii) Externalities arising from the concentration of like enterprises favour certain locations.

iv) Important exchange rates are expected to remain relatively stable

v) The production technology has high fixed costs and high m inimum efficient scale relative to global demand or flexible manufacturing technology exists.

vi) The product’s value-to-weight ratio is high.

vii) The product serves universal needs.

Alternatively, decentralization of production is appropriate when :

i) Differences between countries in factor costs, political economy and culture donot have a substantial impact on the costs of manufacturing in various countries.

ii) Trade barriers are high.

iii) Location externalities are not important.

iv) Volatility in important exchange rates is expected.

v) The production technology has low fixed costs and low minimum efficient scale and flexible manufacturing technology is not available.

vi) The product’s value-to-weight ratio is low.

vii) The product does not serve universal needs.

2. Scale of Operations

Scale is the synonym for size in business. Business organizations can leverage on their size by making dealings, favourable terms, and volume-discounts with other firms.

Operating the business at scale means allocating and optimizing resources to get the greatest results and volume in all market segments. It is linked with optimization, not duplication, of efforts. Keeping costs under control while increasing the sales offers the opportunity for reducing costs and acquiring new customers, and more market share, without lowering the average margin (economies of scale).

Small-Scale Business − Also termed a small business, a small-scale business employs a small number of workers and does not have a high volume of sales. The U.S. Small Business Administration states that small-scale businesses have fewer than 500 employees. Financially, a non-manufacturing small-scale business is one that earns below or equal to $7 million a year.

Large-Scale Business − Based on the home country and the industry, a small-scale company usually employs between 250 and 1,500 people. Anything above that is a large-scale company.

Economies of Scale − It refers to the cost advantages that a business obtains due to its size, output, or scale of operation. Usually, cost per unit generally decreases with the increasing scale, as fixed costs are spread out over more products.

3. Cost of Production

It is a cost incurred by a company in manufacturing a product or delivering a service. Production costs depend on raw material and labour. To determine the cost of production per unit, the cost of production is divided by the total number of units produced. It is important to know the cost of production to better price an item or a service and to decide its total cost to the company.

Cost of production includes both Fixed and Variable Costs.

- **Fixed costs** do not change with the level of output. They usually include rents, insurance, depreciation, and set-up costs. Fixed costs are also known as **overhead** cost.
- **Variable** costs refer to those costs which vary with the level of outputand are also known as **direct costs** or **avoidable costs**. Examples include fuel, raw materials, and labour costs.

4. Make-or-Buy Decisions

Make-or-buy decisions are taken to arrive at a strategic choice between manufacturing an item internally (in-house) or buying it externally (from an external supplier). The buy side of the decision is also known as outsourcing. Make-or-buy decisions of a firm is important when it has developed a product or part – or significantly modified a product or part – but is having problems with the current suppliersor has decreasing capacity or changing demand.

The major reasons for manufacturing an item in house includes the following −

- Cost attributes (less expensive to make)
- Intentions to integrate the operations
- Productive use of excess plant capacity (using present idle capacity)
- For direct control over production / quality
- When design secrecy is applicable to protect proprietary technology
- Unreliable / incompetent suppliers
- Very small quantity of production
- Controlling lead time, transportation, warehousing costs
- Political, social, or environmental pressure

Buy decisions are applicable under the following conditions −

- Insufficient local expertise
- Cost considerations (less expensive)
- Small-volume requirements
- Limited production or insufficient capacity
- Intentions to maintain a multiple-source policy
- Indirect managerial control factors
- Procurement and inventory factors
- Brand preference

Global Supply Chain Management

Globalization is changing the way the international firms used to deal with their supply chain networks. This is happening because companies are actively seeking to compete and gain market share. Global companies nowadays manage multiple supply chains, not only to deliver goods on time, but to meet diverse customer and supplier wants related with pricing and packaging. Personalizing the offerings for various customer clusters is necessary to address these issues.

Volatility of markets, economic contractions and mediocre recovery cycles influence distribution, manufacturing, invoicing and sourcing. Reaching out to encompass new markets brings complex taxation, invoicing and localization burdens. Moreover, dispersed segments of markets ask for different pricing models and services. Hence, optimizing the supply chain is necessary to stay competitive.

A "**supply chain**" refers to the collection of steps that a company takes to transform raw material components into a final product that is delivered to customers. Typically, supply chain management has five stages: plan, make, source, deliver and return. The global supply chain management major focuses on global business and prepares students for success.

Supply chain management (SCM) is "the systemic, strategic coordination of the traditional business functions and the tactics across these business functions within a particular company and across businesses within the supply chain, for the purposes of improving the long term performance of the individual companies and the supply chain as a whole.

Functions of Supply Chain Management - The main functions of Supply Chain Management are as follows:

i. Inventory Management
ii. Distribution Management
iii. Channel Management
iv. Payment Management
v. Financial Management
vi. Supplier Management
vii. Transportation Management
viii. Customer Service Management

Why do we need Global Supply Chain Management

The following forces are drive the trend towards globalization:

1) **Global Market Forces** - Foreign competition in local markets affect business significantly. The growth in demand of foreign products across a wide range of products forces companies to develop and enhance leading- edge technologies and products.

2) **Technological Forces** – There is knowledge diffusion across national boundaries, hence need for technology sharing is required to be competitive. Global location of R&D facilities and frequent collaborations between companies in different regions is done to gain access to markets and technologies.

3) **Global Cost Factors** - Availability of skilled/unskilled labour at lower cost is a decisive factor in determining factory location. Integrated supplier infrastructure (as suppliers become more involved in design) andcapital-intensive facilities like tax breaks, price breaks etc. are also other factors which decide the costs issues.

4) **Political and Economic Factors** - Tariffs, Quotas, Voluntary export restrictions, local content requirements, environmental regulations, government procurement policies (discount for local),exchange rate fluctuations and operating flexibility are some ofthe political and economic factors which regulate the drive towards globalization.

Global supply chain issues

There are various issues in managing global supply chains which are as follows:

1. External Environment–The presence of different economic unions like EU, NAFTA, ASEAN etc has played an important role in the areas of transport deregulation, harmonization of legislation across different countries, reduction of tariff barriers, elimination of cross border customs requirements and tax harmonization. There have been huge changes in logistics also considering the lack of travel restrictions between member countries of different unions.

2. Supply–In terms of inbound logistics or raw material sourcing, there have been many technological and organizational changes. These include :

- **i) Manufacturing Technology** (CIM etc) – It can accommodate more complex production requirements and more product variations.

ii) **New Supplier Relationships**–Here the emphasis is on single sourcing or lean supply thus enabling suppliers and buyers to work together.

iii) **Focused factories** – These means concentration on fewer sources. However, this also at time increases transport journeys.

iv) **Transnational Sourcing** – Sourcing has moved from local and national to global levels.

v) **Postponement** – When there is a chance of holding of stock, there is a purposeful delay in the producing the products so that stock-holding is reduced.

vi) **Co-Makership** – This is the development of partnerships between suppliers and buyers to help take costs out of the supply chain through quality and information improvements.

vii) **Co-Location** – The joint physical location of supplier operations on or next to customer production sites.

3. Distribution – Distribution channels have more or less remained the same barring a few changes which are as follows :

i. New types of vehicle systems like demountable vehicles

ii. Stockless depots operating cross – docking arrangements

iii. Paperless information systems especially in depots

iv. Interactive routing and scheduling for road and transport operations

v. Increasing dependence on third party distribution

4. Extended and Unreliable Transit Times – The use of sea freight is considerably expensive as well as time taking. Hence the use of air freight is growing. Shorter transit times and swifter transit modes are the key to global supply chain management.

5. Multiple Considerations and Break Bulk Operations – The management of international freight is several and these can be managed as follows:

i) Direct ship from source to final market in full containers.

ii) Consolidate in the supply region for the final market in full containers.

iii) Consolidate from each source for each theatre of operation with break bulk / intermediate inventory in the theatre for specific markets.

iv) Consolidate in the supply region and also break bilk in the theatre of operations.

6. Multiple Freight Mode and Cost Operations - Shipping companies offer mixed sea/air service es, different container sizes, schedules & unscheduled services, extended lead times involved in long sea passages etc. However, the use of air freight although expensive is becoming more popular because less transit time and lesser inventory holding costs.

7. Retailing – Since the retail market has grown exponentially over the past few years, it is but evident that the logistics sector will undergo a host of changes.Quality considerations.

Quality Aspects in Global Business

Definition of Quality – It is the totality of features and characteristics of a product or service that bear on its ability to satisfy stated or implied needs.

Quality Issue in Global Business - Product quality is the product's ability to fulfil the expectations and needs set by the end user. In the international market product quality is of prime consideration as it has to cater to a wide range of customers who have different set of expectations and are different culturally.

A high quality product is one that satisfies the preferences and expectations of the customers. The various quality issues which can arise are as follows:

1. National & International Standards–The standardization of products at national and international levels had led to reliability and quality in products.

2. **Legal Requirements –** Legal requirements ensure that during production of any production standards in terms of safety and quality are maintained.

3. Failure Analysis – Each product should be tested for failure before it is launched because any company cannot afford for its product to fail after being launched in the market. Therefore, it is important to carry out a failure-analysis during the conceptual phase in the design of the product. Greater the complexity of the product, the more time, effort and money is required for a failure analysis, but it is essential because stakes are high.

4. **Standardization–** There are several reasons why standardization (national or international) is required:

- **i)** To remove barriers caused by differences in standards so as to ensure suitability of a product.
- **ii)** To reduce the no. of varieties of common user components for eg screws and bolts.
- **iii)** To simplify quality control.
- **iv)** To reduce logistics requirements and support costs by reducing no. of varieties of common user components.

5. **Process Capability –** It is very important to understand the process capability of a manufacturing organization to meet the levels of quality specified in a product design. The skills and experience of shop floor personnel, the accuracy levels of the machinery being used, and the availability of appropriate components are vital to the process capability.

6. **Quality Control–**The aim of quality control is to reject unsatisfactory items. The extra costs involved when items are rejected include costs of scrapped components, cost of reworking rectifiable defects, cost of procuring additional material, cost of additional production capacity, delay in meeting delivery dates etc.

7. **Quality Circles–**A quality circle consists of a small group of employees who carry out similar work under a supervisor; this group meets regularly to isolate quality problems, investigate causes of these problems, recommend solutions and take corrective action.

8. **Delivery, Execution & Commissioning–**The packaging of the product along with the delivery is of utmost importance. The design team have to be involved in all these aspects as the transportation and containerisation of product plays a key part in effective delivery.

9. **User Instructions –** The user instructions have to be clear and concise so that there is no miscommunication.

Quality Considerations

The quality considerations to be take into account for the globalization of market is as follows:

1) Control by Employees – Quality Control Circles by employees who assess the quality of a product and give suggestions for improvement.

2) Control by Sampling – Random selection and testing of products can be done to determine whether the standards are met with or not.

3) Control by Monitoring Complaints – Some of the problems in a product become known only after the consumers start using it and then provide feedback.

4) Correcting Deficiencies – Once a problem is identified in terms of quality of product, the deficiency has to be corrected.

Quality Standards

ISO (International Organization for standardization) is the world's largest developer and publisher of international standards. There are different standards for different sectors which are mentioned below :

1) **Quality – ISO 9000 series** – These are universally recognised and applicable and deals with fundamentals of quality for any sector.
2) **Environment** – ISO 14000 series
3) **Aerospace** – AS9100
4) **Automotive** – QS 9000, ISO/TS 16949, ISO 14001
5) **Statistics** – ANSI/ASQ Z 1.4-2008
6) **Telecommunications** – TL 9000
7) **Information** – ISO 27000 series

Globalization of markets

Globalization of markets refers to the process of integrating and merging of the distinct world markets into a single market.

Features of Globalization of Markets

1. The size of the company doesn't matter. Even small and medium size companies can aim for a global presence.
2. Companies need to formulate different strategies for different markets while aiming for globalization as each nation has its own distinct preferences.
3. Most of the non-consumer goods like industrial products, equipment, machinery etc are likely to have more access to foreign markets.
4. There is always competition among global firms not only in the country of their origin but also other countries where they are doing business.

Need for Globalisation

1. Mass production has led to companies looking for new areas to sell their products.
2. To diversify the portfolio and reduce risk.
3. Increasing profit.
4. To cater to the demands of the foreign market.

Global Marketing

It is the marketing activity which is carried out across national boundaries. It is also known as **multinational / multiregional / international marketing**.

Definition – International marketing is the multinational process of planning and executing the conception, pricing, promotion, and distribution of ideas, goods, services to create exchanges that satisfy individual and organizational objectives.

Characteristics of Global Marketing

1. **Large Scale Operations** – Generally global marketing transactions are held in bulk quantity so that the manufacturers can take advantage of economies of scale.

2. **Stiff competition among multinationals** – Usually the internationalmarketing scenario is dominated by multinational corporations where there is fierce competition among the players in terms of quality and pricing.
3. **International Barriers and Trading Blocs** – The presence of different blocs restrict the free flow of goods and services from non-member countries.
4. **Need for Marketing Research** – As because the stakes are high, companies need to do strong marketing research in terms of pilot surveys, product surveys and product testing before they venture out into new markets.
5. **Use of Advanced Technology**–A lot of companies enjoy more market share due to their highly advanced technology which helps them produce better products at lower prices.

Marketing strategy

Any firm which wants to enter an internationalmarket must take decisions on the following points:

1) **Global Marketing decision**–This involves questions like whether the company should go for an international market? Why should a company prefer to enter global market? Is the company capable of transacting in international markets? Obviously, answers come from company's current domestic market position and types of opportunities available in the foreign markets. When international markets seem to be more attractive and the company is capable to exploit these markets, the company decides to enter the international markets.In short, a company prefers to enter the international market in following situations:

i) When company's has excess production capacity and there exists attractive opportunities outside, and/or

ii) When, compared to domestic markets, foreign markets seem more attractive or profitable, and/or

iii) When company has enough capabilities to deal with international markets, and/or

iv) When domestic governments insist, force, and/or encourage businessmen for international markets.

2) Market Selection Decision: Once a firm has decided to enter the international market, the next important marketing decision is market selection. As per company's present product mix, production capacity, and proposed expansion strategy, it selects one or more countries to operate in. In the same way, it has to decide on type of foreign buyers to be served.

Market segmentation and target market selection are two basic issues in the decision. Initially, a firm targets the most attractive and comparatively easy international markets. Global marketing research can help a company to study international consumer behaviour, segment international market, and select a few most profitable markets.

To assess international markets, following criteria may be used:

- Present market opportunities
- Future market opportunities
- Market share
- Uncertainties and challenges
- Cost-profit estimates
- Return on investment

3) Market Entry Decision: A firm has selected international markets to operate in. Now, the next imperative marketing decision is market entry, i.e., how to enter the market; which of the options to be used for foreign market entry. There are several options to choose an appropriate entry strategy like exporting, opening branch in foreign market, appointing distributors, direct foreign investment or joint ventures.

4)Marketing Mix Decision: Marketing mix decision involves preparing marketing mix (strategies) for international market. Marketing mix consists of 4P’s – product decisions, pricing decisions, promotion decisions, and place or distribution decisions. Marketing mix decisions remain same as domestic market except the target market. Here, all marketing mix decisions are taken with reference to foreign customers and global marketing environment.

5)Organisation for Global Marketing: Organisation for global marketing is an important decision. In order to implement, direct, and control international marketing efforts, a company must adopt an appropriate organization structure. The organisation is responsible to regulate foreign trade.It is same as domestic marketing organisation; the only difference is that it is prepared to administer international marketing operations and activities. Structure depends on a lot of factors such as type of products, number of countries, type of buyers, etc. Sometimes, it is treated as the department or part of main organisation, for example, foreign trade department.

Impact of Global marketing

The advantages and disadvantages of global marketing are as follows:

International Product Decisions

The important product decisions needed to be taken in global marketing management are as follows:

1) Identification of Products for International Market:

The firm has to carry out preliminary screening, that is, identification of markets and products by conducting market research. A poorly conceived product often leads to marketing failures. It was not a smooth sailing in the Indian market for a number of transnational food companies after the initial short-lived euphoria among Indian consumers like Pizza Hut, McDonald’s etc.

2) Developing Products for International Markets:

Various approaches followed for developing products for international markets are as follows:

i) Ethnocentric Approach:

This approach is based on the assumptionthe home country is superior to the foreign country. The consumer needs and market conditions are more or less homogeneous in international markets as a result of globalization. A firm markets its products developed for the home market with little adaptation. Generally, an exporting firm in the initial phases of internationalization relies too heavily on product expansion in international markets.

This market extension approach of product development facilitates cost minimization in various functional areas and a firm gains rapid entry into international markets. However, the ethnocentric approach does not always lead to maximization of market share and profits in international markets since the local competitors are in a relatively better position to satisfy consumers’ needs.

ii) Polycentric Approach:

An international firm is aware of the fact that each country market is significantly different from the other. It therefore adopts separate approaches for different markets. In a polycentric approach, products are developed separately for different markets to suit local marketing conditions.

iii) Regiocentric Approach:

Once an international firm establishes itself in various markets the world over, it attempts to consolidate its gains and tries to ascertain product similarity within market clusters. Generally, such market clusters are based on geographical and psychic proximity.

iv) Geocentric Approach:

Instead of extending the domestic products into international markets, a firm tries to identify similarities in consumption patterns that can be targeted with a standard product around the world. Psychographic segmentation is helpful in identifying consumer profiles beyond national borders.

In a geocentric approach to product development, there is a high degree of centralization and coordination of marketing and production activities resulting in higher economies of scale in the various constituents of the marketing mix. However, it needs meticulous and consistent researching of international markets.

3) Market Segment Decision:

The first product decision to be made is the market segment decision because all other decisions—product mix decision, product specifications, and positioning and communications decisions—depend upon the target market.

4) Product Mix Decision:

Product mix decision pertains to the type of products and product variants to be offered to the target market.

5) Product Specifications:

This involves specification of the details of each product item in the product mix. This includes factors like:

i) Product Attributes:

Some of the key characteristics and features of a product are its quality, styling, and performance. These characteristics are affected by consumer needs, conditions of product use, and ability to buy. The factors that affect product attributes change from country to country.

ii) Packaging:

The main concerns in packaging a product are product protection and promotion. For example, in a hot and humid climate product deteriorate rapidly. Special packaging is necessary to minimize the deterioration of the product. An international marketer has to pay attention to this aspect in designing the packaging material for the product.

In designing the packaging material for promotion, an international marketer has to consider different aspects, such as colour, size, appearance, disposable income, and shopping habits. When designing packaging for a low-income market, it must be ensured that packaging costs less and the goods are packaged in smaller amounts and sizes. When the product is meant for a high-income market the packaging must be in large amounts and must be durable, because, high-income buyers, in general, go for shopping very infrequently.

iii) Labelling:

The primary role of labelling is to provide information. Often the host governments determine the information requirements. The information the manufacturer may be asked to provide includes description of weight, contents, ingredients, product dating, name of the manufacturer, and unit price information. Language difference is a barrier for a firm operating in international markets. When it is operating in overseas markets the labels have to be translated into local languages. Alternatively, the firm can use internationally recognized symbols or multilingual labels.

iv) Service Policies:

Services of physical products can be classified into pre-sale services and post-sale services. Pre-sale services include delivery, technical advice, and postal services. Post-sale services include repair services, maintenance, and operating advice. The level of service necessary depends upon the complexity of the product.

The more complex the product the greater the demand for pre-and post-sales service. When an international firm appoints foreign distributors and agents for providing service it has to train them adequately to meet its after sales needs. The emphasis it lays on service support must be proportionate to the value the customer attaches to the service support.

v) Warranties:

A warranty is a written guarantee of a manufacturer's responsibility when a product fails to perform. Through warranties a firm takes responsibility for repair and replacement of defective products. Warranties must conform to local laws both in terms of product standards and a manufacturer's liability.Local consumers in many countries view the products manufactured by a foreign firm as less dependable. Providing a strong warranty can go a long way in assuring the local consumers about the trustworthiness of the product. The international firm can in fact use the superior warranty protection as a promotional tool.

5) Positioning and Communications Decisions:

Positioning is the image projected for the product. Communication refers to the promotional message designed for the product. Obviously, both positioning and marketing communication are very much interrelated. For the same product, sometimes the positioning and communication strategies differ between markets.

6) Product Elimination:

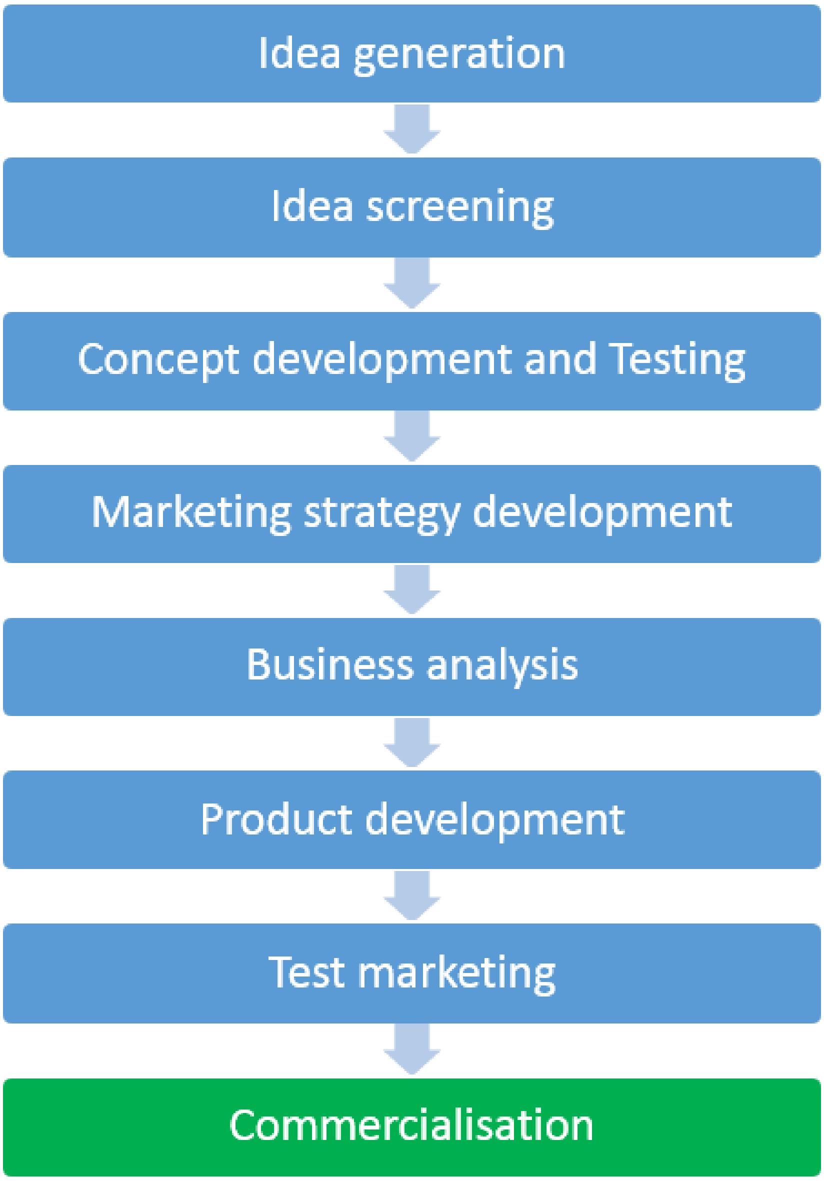
Product Elimination is one of the most important product related decision. Too many product introductions can risk overburdening the firm's marketing system. There is a constant need for a regular review of the range and for elimination decisions to be made where a product is either in its decline stage or simply failing to generate sufficient profit.The international perspective, however, means that decision-making is more difficult, since a product may be manufactured principally in a plant in one country, be a 'cash cow' in one market and a 'dog' in another. Careful analysis is therefore needed before the product elimination decision is taken. The identification of overlaps in the product range or poor performance of specific products may necessitate elimination of products if they are in the declining stage of the product life cycle, have been duplicated or have been replaced by a newer product.

7) Product Diversification:

Diversification means seeking unfamiliar products or unfamiliar markets, or both, for the purpose of expansion. Diversification requires substantially different and unfamiliar knowledge, thinking skills, and processes. Thus, diversification is at best a risky strategy, and a company should choose this path only when current product/market orientation seems to provide no further opportunities for growth.

New Product Development

New Product development is a journey. It's the road which leads to the actual product and then the actual product to the market. Every product goes through a number of stages before being introduced in the market. The following steps are involved in new product development:



1. Idea Generation

The first stage of the New Product Development is the idea generation. Ideas come from everywhere, can be of any form, and can be numerous. This stage involves creating a large pool of ideas from various sources, which include –

- **Internal sources** – many companies give incentives to their employees to come up with workable ideas.
- **SWOT analysis** – Company may review its strength, weakness, opportunities and threats and come up with a good feasible idea.
- **Market research** – Companies constantly reviews the changing needs, wants, and trends in the market.
- **Customers** – Sometimes reviews and feedbacks from the customers or even their ideas can help companies generate new product ideas.
- **Competition** – Competitors SWOT analysis can help the company generate ideas.

2. Idea Screening

Ideas can be many, but good ideas are few. This second step of new product development involves finding those good and feasible ideas and discarding those which aren't. Many factors play a part here like company's strengths, weaknesses, customer needs, ongoing trends, expected ROI, affordability, etc.

3. Concept Development & Testing

The third step of the new product development includes concept development and testing. A concept is a detailed strategy or blueprint version of the idea. Basically, when an idea is developed in every aspect so as to make it presentable, it is called a concept. All the ideas that pass the screening stage are turned into concepts for testing purpose. You wouldn't want to launch a product without its concept being tested.

The concept is now brought to the target market. Some selected customers from the target group are chosen to test the concept. Information is provided to them to help them visualize the product. It is followed by questions from both sides. Business tries to know what the customer feels about the concept. Does the product fulfil the customer's need or want? Will they buy it when it's actually launched?Their feedback helps the business to develop the concept further.

4. Marketing Strategy& Development

The testing results help the business in coming up with the final concept to be developed into a product. Now that the business has a finalized concept, it's time for it to analyse and decide the marketing, branding, and other business strategies that will be used. This consists of 3 steps:

a) Target market's size, structure, behaviour, product positioning, sales, market share, profit goals

b) The product's pricing strategy, distribution strategy and marketing budget

c) The long run sales and profit goals and marketing mix.

5. Business Analysis

Once the product concept and marketing strategy is developed, the business attractiveness has to be evaluated. This is done by doing a proper estimation of total sales. Costs and profits.

6. Product Development

Once all the strategies are approved, the product concept is transformed into an actual tangible product. This development stage of new product development results in building up of a prototype or a limited production model. All the branding and other strategies decided previously are tested and applied in this stage.

7. Test Marketing

Unlike concept testing, the prototype is introduced for research and feedback in the test marketing phase. Customers feedback are taken and further changes, if required, are made to the product. This process is of utmost importance as it validates the whole concept and makes the company ready for the launch.

8. Commercialization

The product is ready, so should be the marketing strategies. The marketing mix is now put to use. The final decisions are to be made. Markets are decided for the product to launch in. This stage involves briefing different departments about the duties and targets. Every minor and major decision is made before the final introduction stage of the new product development.

Challenges in product development

The various challenges that a firm has to face while developing a new product are as follows :

1) **Global Competition** - Global competition is often a major factor impacting the challenges of new productdevelopment. Since the playing field is large and diverse, often spanning the globe, it may bevery difficult for companies to gather intelligence on competitors. A company may investheavily in a new productyet be unaware that an overseas competitor is set to release asimilar product imminently. As a result, shepherding a new product from concept to market isoften done under intense time pressure, as product developers attempt to bring the product tomarket ahead of their competition.

Example - Mahindra& Mahindra scoredits first SUV hit with Bolero in 2000. Buildingon this success, in 2002 it launched theScorpio, a model that signalled M & M hadfinally achieved the right mix of design, power,and price. Not it was a looker and aperformer; it cost less than its rivals. TheXylo, launched in 2009 and the XUV500 in2011 have helped M&M consolidate its position.

2) **Time** - The companies today are facing time as one of the critical challenges in new product challenge. Introducing the new product at the right time reduces the ambiguity about the failure of the product. Giving the market a product at a time when there the need for such a product/service is not required is surely a planned way to head for the edge.

Example - Spanish apparel brand ZARA takes just two weeks to create a new product line out of high street fashion design and ship it to stores making it the world's most popular fast fashion‟ brand. Zara has replicated a model that has worked for it globally – creating affordable, copycat versions of the latest fashions or designer-wear and making them available to shoppers in double quick time. Zara is known for its fresh fashion delivery every week. Their weekly delivery supply chain is the best in the world.

3) **Market Potential** - A company needs to know their current and future competitors. In today's economic climate only two products will be successful in any given market. Unless your product is far superior to your competition, you will not be able to enter a market successfully or retain your leadership in the market. While it is initially fine to get to know your competition from searching online, it cannot replace feedback from customers who use the product. Knowing your future competitors will help you to develop a strategy to retain your competitive advantage.

Example - The social media network Facebook has taken the world by storm since it was introduced to the web in 2004. The Harvard student Mark Zuckerberg had no way of knowing how quickly and readily accepted his social networking site would be. An app, known as Instagram, was developed to make photo-sharing easier and quicker for users. Not only could users share their photos quickly, but they could edit them and add special effects to their photos before sharing them. With 1 million iPhone and Android users being added each and every day, Facebook saw Instagram as its fastest growing competitor and decided to take control before it became a problem for Facebook. Facebook acquired Instagram for $ 1 billion which was not an easy or cheap process, but it eliminated the stress of a future competitor, or even worse, the app being acquired by an already powerful competitor such as Google or Twitter.

4) **Technological Change**- Rapid advancement of technology may be considered by many to be among the top challenges of new product development. A technological arms race may put product developers in a precarious position of uncertainty. Product developers may not know what the next development might be. If a firm chooses a pathway to creating functionality using a form of technology that may be soon obsolete, the company's investors could lose a sizable investment.

Example - We believe in the equation Apple =Innovation is a fundamental truth. Starting from the first Macintosh to the ipod, ipad, iphone, the list is still has kept growing and Apple has time again proved that innovation is the ultimate success of a new product. That's why the company stands out of the crowd when it comes to its innovation. The company is a leader in producing innovating products and amazing the customers and making them think that this is it but not for Apple.

5) **Distribution** – There are many questions to be answered here like Who's going to sell the product, can you use the same distribution channels you currently use, can you use the same independent representatives or sales force, is there sufficient salespotential in the new product to convince a distributor, retailer, or agent to take on the new line?There are significant up-front selling costs involved in introducing new products. Everyone inthe channel wants some assurance that the investment of time and money will be recovered.

Example - Taking the first step towards its long- awaited entry into India, US coffee chain Starbucks has signed a pact with Tata group firm Tata Coffee for a possible alliance that could include retail operations and sourcing. Starbucks Coffee Company and Tata Coffee signed a non-binding Memorandum of Understanding (MoU) to collaborate in sourcing of coffee beans and roasting facilities, relating to Starbucks entering retail operations in India initially. The collaboration would also explore other Asian countries over a period of time. The twocompanies will also collaborate on the promotion of responsible agronomy practices,including training for local farmers, technicians and agronomists, to improve theircoffee-growing and milling skills.

6) **New Features**- Competitive advantage needs to be articulated to your customers: how does the product (or attributes of the product) meet your customers' unmet need that no other product can. This is the reason why customers will use your product over any other product. Knowing your competition will validate or invalidate your competitive advantage and potential market leadership. Adding new features can increase your overall product value and consequently, increase your market share. What makes new product development different from product development? While new product development can be revolutionary, product development (i.e. adding new features) is an evolutionary process.

Example - Google is a leader in both areas. The search giant develops revolutionary products (i.e. new product development) and finds ways of improving upon them (i.e. product development). Gmail is one of many Google products that illustrate this point. Once Google mastered the end product, the search giant was able to add new features to increase the products overall value. For instance, enables users to make large changes, such as adding a customized inbox skin or SMS through Gmail chat, and small adjustments such as YouTube e-mail previews. The company is ranked 7th in the most innovative company.

7) **Market Size** - It is also important to keep an eye on the market size as well as the market potential for the product in meeting the business goals of the company. The last thing you want to find out is that there is no market for the product or that the customer isn't buying the product. In addition to meeting a critical unmet need you need to be in a market where you sell a significant amount of product to develop more products and expand your business. It often makes sense to outsource to someone who can determine the size of the market and the market potential for the product in meeting the business goals of the company through market research and talking to potential customers.

Example - A secret new product created by the renowned inventor Dean Kamen was leaked to the press nearly 12 months before the product's release. When investors and the public learned that the invention was actually a technologically advanced motorized scooter, they were dumbfounded. Ads showing riders who looked like circus performers perching on weird-looking chariots didn't help, nor did the price tag $5,000. Instead of selling 10,000 machines a week, as Kamen had predicted, the Segway sold about 24,000 in its first five years.

8) **Price** - Setting the right price of the product before introducing it in the market is also a challenge forthe organisation. Suppose you set the price of your product almost same as that of yourcompetitor and assuming the product is similar in quality and features and the competitor holds agood position in the marketplace, then the success of your product will depend on the market or luck. Thus, setting your product at the right price at the right time is a challenge.

Example - When MICROMAX recently introduced its smartphone model CANVAS. Knowing that it faced a tough competition from the large market leaders like APPLE, SAMSUNG, the company has introduced a beautiful andstriking product which is not only unique from its other products but is also economical inmeeting the Indian customer needs. The ultimate success of the product was its price whichnot only ensured the longevity of the product but also opened gamut of opportunities for thecompany. Currently the mobile is giving a slight competition to Samsung SIII and is quicklyrunning out of stock.

9) **Desirability** – The new product or service must be desirable, i.e. a person wants to use it. The new product or service must have a useful purpose andit should

provide customer satisfaction. When creating and designing a new product or service it is important to consider the use of the product (what does the product do), the level of usability of the product (how does it work, can it be used comfortably) and the meaning that the product conveys.

Example - Considering that the Men cosmetic segment was still untouched in India and thinking of a fairness cream as a unmet need of the customers EMAMI introduced the fair and handsome cream particularly targeting the men consumers. The brand has rightly positioned itself in the new segment though it now faces competition from Vaseline and Garnier. Though communications of this type have raised criticisms from some sectors of the society arguing that fairness of skin implies better acceptability, themarket is growing by over 10% per annum.

10) **Promotion** - Promoting a new product in the new market or in the current market is the job of every marketerand the utmost requirement for the longevity of the product in the market. Firms who hardlypromote their product are rarely recognised by the market and thus remain a mystery product forthe consumers. Promotion techniques adopted by the firms from print media to social websites isall a one step of the staircase approach of NPD. Thus, promotion is must process for the new product hit.

Example - RA ONE was a kind of new product in itself for the Indian movie watchers. Knowing that the movie wasn't upto the mark, the producers adopted a first of its kind advertisement strategy. Newspapers, popular websites, magazines, music channels etc. were all flooded with advertisement posters of the movie, showcasing to the people the unique characters much before the movie was released. Tie-ups with popular brands such as McDonalds, KFC was done as a part of co-branding and increasing the credibility of the movie. Even before its release, Ra One managed to earn a revenue of Rs132 crore simply by giving away the rights of the movie. The cost of the movie was 100 crores and 52 crore were spent only in its promotion.

11) **Resistance to Change**- Most customers are intrinsically conservative and resist innovation. Apart from the few early adopters, whose enthusiasm for new products knows no bounds, the broad mass of customers sees innovation as risky and finds new unproven products less attractive than tried and tested alternatives. Consequently, any innovative product, particularly if it has a high technological

component, will meet resistance and will sell slowly until it is perceived as safe by potential customers.

Example - Often cited as the ultimate example of one of the most notorious product flops - and brand missteps - of all time, New Coke was launched in the mid-1980s by Coca Cola in an attempt to help the soda company stay ahead of competitors during the so-called "cola wars."Instead, it just annoyed consumers. The tacky way it was introduced made it seem as though the regular Coke drinkers mattered little to the company and a boycott was started.

Global Pricing

Pricing on an international level is a very difficult task. It takes into account the traditional price i.e. the cost of the product in the local market including fixed and variable rates. It also determines the competition prevailing in the market between a particular company's products and similar products of other companies. **The following are the objectives of global pricing:**

1. Market penetration: In penetration and pricing, price is used as a competitive weapon to gain market position. Penetrative pricing means a product may even be sold at a loss for a certain length of time. So, companies new to exporting cannot absorb such losses. A low price is charged in the initial period or until the product gains acceptance of the buyers. This method of pricing attracts buyers who are sensitive to price, effects large volume of sales, avoids competition and stabilizes the price.

2. **Market skimming**: In skimming, a high initial price is charged in a market segment which is willing to pay a premium price for a product. In skimming pricing, the product must create a high value for the buyers. This is often used in the introductory phase of the product life cycle when both production capacity and competition are limited. Sony used skimming strategy when it introduced Betamax video cassette recorders in the United States.

3. **Market share**: The efficiency of the product may be evaluated in terms of market share it holds. Increasing the market share is a sure way to lower costs. A larger market share might increase profitability because of greater economies of scale.

4. **Meeting competition**: The present market is highly competitive. When a product is introduced in a competitive market, meeting competition can be an important objective. The price must remain competitive in order to gain a competitive edge in the market.

5. **Preventing potential competition**: The objective of pricing may be to prevent the entry of new competitors into the market. When a low price is set on the product, the marketer may incur loss. This discourages the competitors to gain an entry into the market with similar product.

6. **Early recoupment of investment**: Some products may have short product life cycle. They may also be affected by swift technological changes. There may also be potential danger of political threats and cut throat competition. In such a situation, the marketer may have the objective of recouping his investment as early as possible. Prices bring revenue to the firm. A high price determined in the initial period may help the manufacturer recoup the investment in the project early.

7. **Quick cash recovery**: When a firm has liquidity problem, it may prefer to generate quick cash flow. The pricing method adopted by it may liquidate the stock quickly thereby encouraging channel members and buyers to make prompt payment.

8. **Discharging export obligation**: Having gained a good market share in the domestic market, the firm may be willing to foray into foreign market. Entering foreign market and meeting export obligation may not be easy for all firms. Sometimes, even by charging a price lower than the cost, the firm gains a share in the foreign market.

9. **Disposal of surplus**: When a firm has surplus stock, it may resort to dumping. Dumping is an important global pricing strategy. It is the sale of an imported product at a price lower than that is normally charged in a domestic market or country of origin. The firm views export sales as passive contribution to sales volume.

10. **Return on Investment**: Price is the only source of revenue to the firm. The firm has to earn sufficient revenue in order to meet the needs of stakeholders. It may set a target rate of return on its investment. Pricing serves to secure the target rate of return on the investment.

11. **Profit maximization**: Profit is by far the most important pricing objective. Prices are viewed as active instrument for profit maximization. In general, pricing is a tool of accomplishing marketing objectives. The firm may use price to achieve a specific objective, whether a targeted rate of return on profit, a targeted market share or some other specific goal.

Global Pricing Approaches

The different approaches followed in international pricing are as follows:

1. **Cost – based pricing**-Another name for this method is 'cost plus pricing'. In this, various costs (direct and indirect) are added and then a profit mark-up is added to get the price of the product.

Price = (Fixed Costs + Variable Costs + Overheads + Marketing Costs) + Specified % of total costs

2. **Market – Oriented Pricing**– This approach in pricing allows the changes in price on the basis of the market conditions. Firms can increase the price when there is greater demand and decrease it when there is lesser demand. So there is flexibility in pricing decisions.

3. **Competitive Pricing** –Many firms set the price on the basis of the prices set by the price leader. Here the market leader is the price setter or initiator and others are followers. The followers can set their price either equal to as the initiator or set the price below that of the competitor or above that of the competitor. This depends on the quality of the firm's product, its brand image, brand loyalty etc.

4. **Marginal Cost Pricing** – This method of pricing is followed in evaluating the profitability of new orders in the scenario where the firm has excess capacity. Under this method of pricing, only the variable cost of the product is considered a relevant cost, while the fixed cost is ignored.

5. **Other Pricing Approaches**

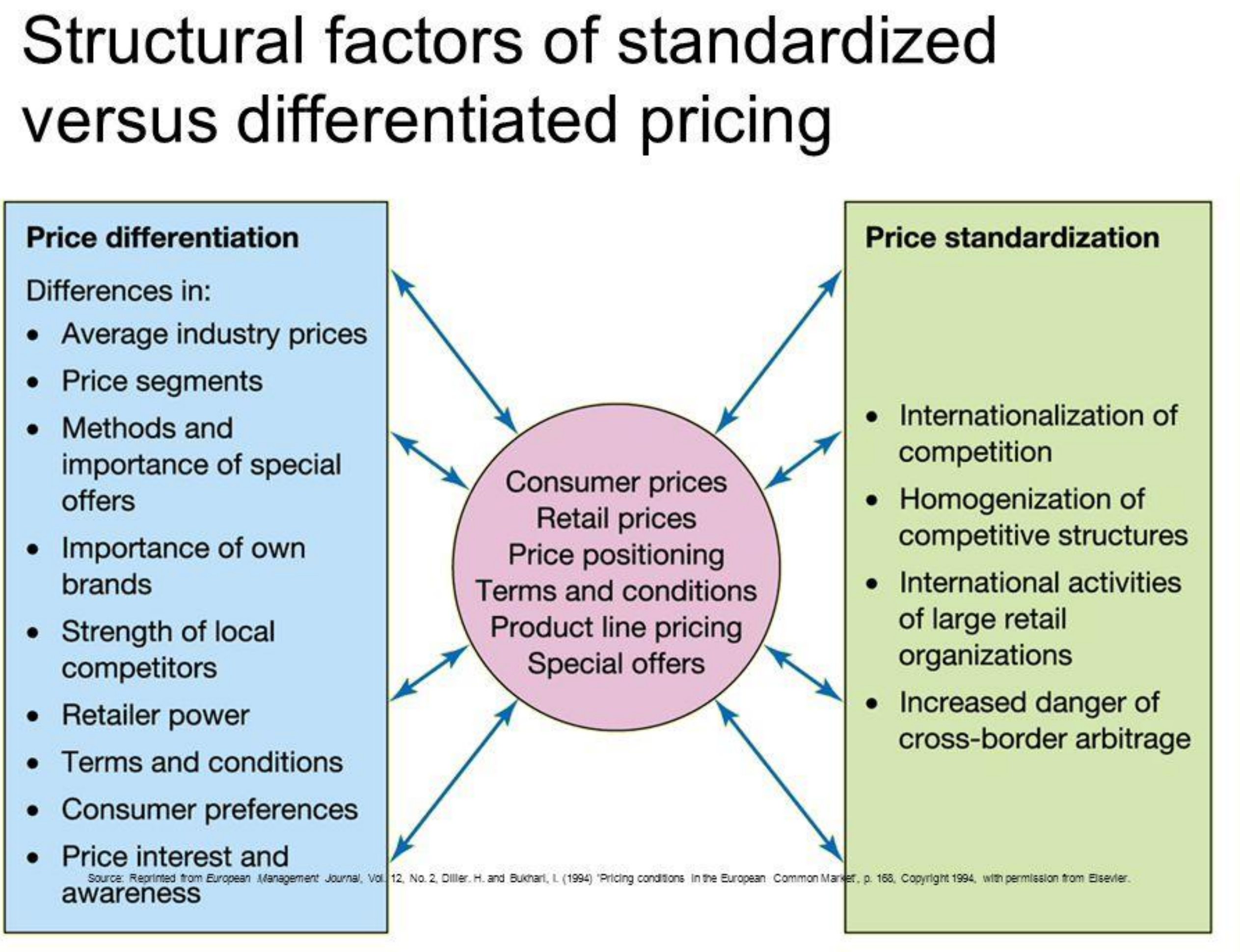
   i. **Negotiated Pricing** – In this the price is set up as a process of negotiation between the buyer and the seller. It is a flexible process and is usually seen in price negotiations between government and institutional purchase orders.

ii. **Customer – Determined Price**–At times the customer/ buyer decides the price at which he is ready to buy the product. The actual supply will depend on the conditions like the cost structure of the seller, his profit expectations, the kind of business objectives and his vision.

iii. **Break – even Price** – The break – even point is the price where the firm makes no profit or loss. It is arrived by dividing the total of all costs involved in producing and selling the product by the number of units of the product. This break – even analysis helps in deciding the minimum level of sales where the firm will not make a profit or loss.

iv. **Creative Pricing**–It is used in case of marginal costing. Here, the flexibility between prices of the competitors (upper limit) and break-even price (lower limit)is used to decide the price.

Price Standardization Vs Differentiation



Price Standardization / Uniform Pricing – Price strategy for international markets based on setting a price for the product as it leaves de factory. At its simplest it involves setting a fixed world price at the headquarters of the firm. This fixed world price is then applied in all markets after taking account of factors such as foreign exchanges rates and variance in the regularity context. This pricing strategy might be appropriate if the firm sells to very large customers, who have companies in several countries. In such a situation the firm might be under pressure from the customer only to deliver at the same price to every country subsidiary, throughout the customer´s multinational organization. Another advantage of price standardization includes the potential for rapid introduction of new products in international markets and the presentation of a consistent price image across markets.

Price Differentiation / Market by Market Pricing - Price strategy for international markets that allows each local subsidiary or partner (agent, distributor. etc.) to set a price that is considered to be the most appropriate for local conditions, and no attempt is made to coordinate prices from country to country. The weakness of the price differentiation strategy is the lack of control that headquarters has over the prices set by the subsidiary operations or external partner. Significantly different prices may set in adjacent markets and this can reflect badly on the image of multinational firms. It also encourages the creation of parallel importing and grey markets, whereby products can be purchased in one market and sold in another, undercutting the established market prices in the process.

Issues in Global Pricing

Some of the important issues related to product pricing in international market are as follows:

1) Governmental Intervention: Every country has laws that either directly or indirectly affects prices to the final customer. Government in most countries today plays an important role in product pricing. Price controls may set either maximum or minimum prices for designated products. Government price controls prohibits certain competitive pricing practices. However, a firm may charge different prices in different countries because of competitive and demand factors For Example; a firm may choose to exclude fixed costs in the price calculation of products exported to developing countries in order to be price competitive in those markets. The interventions of government can be direct or indirect.

2) Greater Market Diversity: Country to country variation creates natural segments and a company sets different prices for different countries on the basis of competitive situation and stage of product in the product life cycle.

i) A skimming strategy sets a high price for a new product, which is aimed at market innovators. Over time, the price will be progressively lowered in response to demand and supply conditions, i.e., the presence of additional competitors.

ii) A penetration strategy sets an aggressively low price to attract a maximum number of customers (some of whom may switch from other brands) and to discourage competition.

iii) A simple cost-plus strategy sets the price at a desired margin over cost.

Country-of-origin stereotypes also limit pricing possibilities. But there is a problem in lowering the prices that they may affect the product image in future.

3) Price Escalation in Exporting: To compete in export markets, a firm may have to sell its products to intermediaries at a reduced price in order to lessen the amount of price escalation. Price escalation in exporting is a phenomenon that occurs all too often. If the exporting firm does not pay conscious attention to the conditions that lead to price escalation it may find itself in a situation where it prices itself out of a foreign market.

In general, it is the physical and economic distance between the initial manufacturer and the consumer (or user for industrial products) that provides the environment for price escalation to emerge.

4) Currency Value and Price Changes: In the case of highly volatile currencies pricing can be extremely difficult, especially under conditions of high inflation. The pricing decision must consider the replacement cost. Pricing decisions must assure the company of sufficient funds to replenish inventory, which might result in the need for frequent price adjustments.

Further, currency fluctuations also affects product's pricing decisions that faces foreign competition; when a currency is strong, producers may have to accept a lower profit margin if they wish to be price competitive.

5) Fixed versus Variable Pricing: Fixed price is that which held constant for a specified period of time. It exists in situations where a branch of government has some degree of control and retailers must conform to a stated price structure.

Variable price is a pricing strategy wherein a retailer alters its prices to coincide with fluctuations in costs or consumer demand. This type of pricing is common among street vendors, antique dealers, and other small, independently owned businesses but is not practical for direct marketers, who rely upon preprinted promotion forms. Variable pricing risks the loss of customer goodwill when one customer discovers another paid less.

6) Company to Company Pricing: Dominant retailers with substantial clout may get suppliers to offer them lower prices, which in turn will enable them to compete as the lowest-cost retailer. However, such clout may not exist in new foreign markets. In addition, many industrial buyers are claiming large price reductions through Internet purchases.

Global Distribution Channels

A distribution channel is a chain of businesses or intermediaries through which a good or service passes until it reaches the end consumer. Channels are broken into direct and indirect forms. Distribution channels can include the manufacturer, warehouses, shipping centers, retailers and even the internet. Direct channels allow the customer to buy goods directly from the manufacturer, while an indirect channel moves the product through other distribution channels to get to the consumer. Firms that use direct distribution require their own logistics teams and transport vehicles. Those with indirect distribution channels must set up relationships with third-party selling systems. Produced goods and services have to find a way to reach consumers. The role of the distribution channel is to transfer goods and services efficiently. They can either be sent to a retail store or directly to a customer's residence.

Direct Distribution

A direct distribution channel is organized and managed by the manufacturer itself. Direct channels tend to be more expensive to set up at the beginning and can sometimes require significant capital investment. Warehouses, logistics systems, trucks and delivery staff will need to be set up. However, once those are in place, the direct channel is likely to be shorter and less costly than an indirect channel.Direct selling can be difficult to manage on a large scale, but it often allows the manufacturer to have a better connection to its consumer base.By controlling all aspects of the distribution channel, a manufacturer has more control over how goods are delivered. They have more control over cutting out inefficiencies, adding new services and setting prices.

The various types of foreign intermediaries are:

1. **Foreign Distributor** – A foreign distributor is a foreign firm that has exclusive rights to carry out distribution for a manufacturer in a foreign country or specific area. To carry out the distribution function, the foreign distributor is often required to warehouse adequate products, parts, and accessories and to make facilities and personnel immediately available to service buyers and users.

2. **Foreign Retailer**–If foreign retailers are used the product in question must be a consumer product rather than an industrial product. The manufacturer may contact foreign retailers by different means to decide with whom to collaborate.

3. **State Controlled Trading Company** – For some products like utility and telecom, a manufacturer must contact and sell to state controlled companies.

4. **End User**–Sometimes a manufacturer is able to sell directly to foreign users with no intermediaries in the process.

Indirect Distribution Channel

An indirect distribution channel relies on intermediaries to perform most or all distribution functions, otherwise known as wholesale distribution. The most challenging part of indirect distribution channels is that another party has to be entrusted with the manufacturer's products and customer interaction. However, the most successful logistics companies are experts at delivering receivables in a way that most manufacturers cannot be.

The local sales intermediaries can be grouped under two broad categories domestic agents and domestic merchants.

1) Domestic Agents – They never take title to the goods regardless of whether they take possession of the goods or not. Some agent intermediaries represent the buyer whereas others represent the manufacturer.

a) Agents who look after the interest of the manufacturers

i) Export Broker - An export broker is a firm or an individual responsible for bridging the gap between the seller and the buyer. It functions as an intermediary between the organization which owns the goods or services meant for export and the overseas organization which intends to import that goods and services. It facilitates the transaction between the two concerned parties. It also undertakes the smooth facilitation of the perfect shipment of the goods or services. For all these services, the export agent receives a commission and does not take part in actual sales transactions.

ii) Export Management Company (EMC) - An export management company is an independent private organisation which acts like an export department for various non-competing suppliers and manufacturers. An export trading company (ETC) handles the exportation process for clients, navigating all legal requirements and regulations that a company must follow before a country will allow its goods to be exported.Also called export management companies, ETCs can be either local or based in a foreign country, such as the country that imports the goods that the company is trying to properly export.An ETC can provide a firm with local knowledge about the laws and regulations in a foreign country, reduce training and recruitment costs, and help strategize ways to minimize exchange rate risk.

iii) Manufacturer's Export Agent or Sales Representative - The manufacture's export agent (MEA) is an individual agent middleman or an agent middleman firm providing a selling service for manufacturers. Unlike the EMC the MEA does not serve as the producer's export department but has a short term relationship covers only one or two markets, and operates on a straight commission basis. Another principal difference is that MEAs do business in their own names rather than in the name of the client. Within a limited scope of operation the MEAs provide services similar to those of the EMC.

iv) Cooperative Exporter - Cooperative exporting, or piggybacking, takes place when a company with an established distribution channel for its own products contracts to export the goods of a non-competing foreign manufacturer. For instance, a Japanese maker of consumer electronics might contract with a U.S. producer of home appliances to market and distribute its appliances in Japan. As another example, a U.S. producer of electronics that exports its goods to Europe may contract to market the same appliance manufacturer's wares through its established European channels.

v) Webb-Pomerene Association - Webb-Pomerene Association is an association engaged in exporting that handles the products of similar producers for overseas sales. The association constitutes an organization jointly owned by competing U.S manufacturers exclusively for hepurpose of export.

b) Agents who look after the interest of the buyers

i. **Purchasing / Buying Agent -** An agent who purchases goods on behalf of foreign buyers. The buying agent represents and buy a specific kind of products within a specific territory, which can be a country or multiple countries. The responsibilities of the Buying Agent may include, among others, the following: identifying manufacturers and suppliers of products within the described territory; negotiating prices; terms of delivery and payment; managing the international transport of documents which comply with export and import procedures; assisting and serving as a translator of the Principal´s representatives when visiting the country to negotiate purchase contracts or to check on the manufacturing of products.

ii. **Country Controlled buying Agent -** governmental agency or quasi-official corporation that is the sole or primary entity authorized to trade with foreign countries for the purchase of certain goods. Very often the buying agent is also the state monopoly for the sale of such goods within the country. Country controlled buying agents are common in centrally planned economies but are used to a lesser extent in market economy countries to regulate imports of liquor, tobacco, and similar luxury or highly taxed products.

iii. **Resident Buyer -** A market representative located in a central market area and acting as buyer and consultant to one or more retailers in a line (as women's clothing) subject to much variation and rapid change. A resident buyer is crucial to providing valuable merchandising information and allows a company to keep in close touch with the market.

2) Domestic Merchants

Domestic merchants own the merchandise regardless of whether the merchants take possession or not. They represent the manufacturer's product instead of the manufacturer.

i) **Export Merchants -** An export merchant purchases products from foreign and domestic manufacturers or producers then repackages them for export under its own name, by taking over all risks and selling the goods to their own consumers. An export merchant is capable of competingfavorably due to its specialized knowledge of the goods in which they deal with, expertise in international trading methods and comprehensive knowledge of the foreign market.

ii) **Export Drop Shipper –**Dropshipping is a type of business model which enables a company to operate without maintaining inventory, owning a warehouse to store their products, or even having to ship their products to their customers themselves. How it works is that the retailer partners up with a dropship supplier that manufactures and/or warehouses products, packages the products, and ships them directly to the retailer's customer, on the retailer's behalf. So an export does the same in an international scenario.

iii) **Export Distributor –**An export merchant and a drop shipper purchases from a manufacturer whenever they receive orders from overseas but an export distributor deals with manufacturer on a continuous basis and is authorised and granted an exclusive marketing right to represent the manufacturer and to sell in some or all foreign markets.

iv) Trading Companies - Trading companies are specialists that cover all export and import operations and procedures. A trading company buy products in one country and sold them in different countries where it has its own distribution network. This kind of companies mostly work with high production volumes of products such as raw materials, chemicals, generic pharmaceuticals, etc.

Challenges in Managing Global Distribution Strategy

1) **Difference between Customer Expectations across Countries** - Culture is a very important factor in international marketing. Culture encompasses everything from the way of thinking and doing business to the consumption patterns of the population. Understanding of the culture is important as it gives vital clues on how to do business in these countries in the best possible way.

2) Differences in Channel Structure & Trade Practices - Countries usually differ in their channel structures. A channel structure is the distribution channel system in operation for a particular product category in a market. In the United States and other developed markets, the distribution channels for grocery items are dominated by large retail chains that often have a larger sales turnover than even a medium-scale manufacturer.The large networks thus effectively control the market. In Finland, it has been reported that about four large wholesaler-retailer chains carry around 92% of all non-durable consumer goods in the country. It is, therefore, difficult for a manufacturer to penetrate the Finnish market without getting cooperation from the dominant chain. For example, in a country like Japan, it is the manufacturer who has greater control. The Keiretsu system in operation in Japan effectively gives greater control to the manufacturers.

3) **Differences in the Quality of Physical Infrastructure** - The international distribution function differs due to the variations in the physical infrastructure across countries. Many under-developed countries lack basic infrastructure like quality roads, railways to enable goods to be freely transported, etc.The impact of differences in logistics and physical infrastructure will have a major impact on international distribution channel management since a large part of the cost incurred in international marketing is on physical distribution.

4) Differences in Distribution Systems between Countries - Differences exist in distribution system of different countries. Three main differences between distribution systems are:

i) Retail Concentration: In some countries, the retail system is very concentrated, but it is fragmented in others. In a concentrated system, a few retailers supply most of the market. A fragmented system is one in which there are many retailers, no one of which has a major share of the market.

ii) Channel Length: Channel length refers to the number of intermediaries between the producer (and manufacturer) and the consumer. If the producer sells directly to the consumer, the channel is very short. If the producer sells through an import agent, a wholesaler, and a retailer, a long channel exists.

iii) Channel Exclusivity: An exclusive distribution channel is one that is difficult for outsiders to access. For example, it is often difficult for a new firm to get access to shelf space in supermarkets. This occurs because retailers tend to prefer to carry the products of long established manufacturers of foodstuffs with national reputations rather than gamble on the products of unknown firms. The exclusivity of a distribution system varies between countries.

Investment decisions

While considering to invest internationally, a company must consider the political, cultural, legal and cultural environment which can influence the cost, benefits and risks of doing business. While taking investment decisions, a manger has to keep in mind the following factors:

1) **Capital Budgeting** - Capital budgeting is investment decision-making as to whether a project is worth undertaking. Capital budgeting is basically concerned with the justification of capital expenditures. It is a process of identifying, analysing and selecting investment projects whose returns (cash flows) are expected to extend beyond one year. The firm's investment decisions would generally include expansion, acquisition, modernisation and replacement of long-term assets. It uses the same framework as domestic capital budgeting, only the calculations are more complicated.

The most important criteria that indicates the feasibility of the project is the **Net Present Value (NPV).** To estimate NPV the following criteria are required:

i) The identification of the relevant expected cash flows to be used for the analysis of the proposed project

ii) The determination of the proper discount rate for finding the present value of cash flows.

Approaches to Capital Budgeting

i) **Payback Period** – It is defined as the no. of years required for the proposal's cumulative cash inflows to be equal to its outflows. It is the break even time for the investment.

ii) **Net Present Value (NPV)**–It is defined as the present value of future cash flows discounted at the appropriate rate minus the initial net cash outlay for the projects. The discount rate here is known as the cost of capital. Basically one has to accept projects with positive NPV and reject projects with negative NPV.

$$NPV = -I_0 + \sum_{t=1}^{n} \frac{CF_t}{(I+k)^t}$$

Where, I_0 = Initial cash investment

CF_t = Expected after-tax cash flows in year t.

K = Weighted average cost of capital

n = Life span of the project

2) **Country Risk Analysis** - Country risk is described as the economic, political and business risks that are distinctive to a specific country, and that might result in unforeseen investment losses. Mainly, Country risk refers to the risk of investing or lending in a country, arising from possible modifications in the business environment that may unfavourably affect operating profits or the value of assets in the country. Country risk signifies the potentially adverse impact of a country's environment on the MNC's cash flows. Country risk covers factors to influence the default risk of the country resulting from economic deterioration, political events, currency depreciation and so on.

Country risk mirrors the ability and readiness of a country to service its foreign financial obligations. Such risk may be encouraged by country-specific and regional economic, financial, political and composite factors. Country risk is major concern in the world today, with almost every economic, financial and political crisis or conflict threatening to exceed their initial borders.

Components of Country Risk

There are two types here – macro and micro risks.

Macro Risks – These risks affect all the MNCs in the same way. These are :

i) **Forced Disinvestment**–At times govt may force companies to disinvest. This may be because the govt. feels that it can make better use of the assets, enhance its own image or wants to control these assets for strategic reasons.

ii) **Un-welcome Regulations** – These regulations decrease the profitability of the MNCs. These regulations can relate to tax laws, ownership, management, re-investment etc

iii) **Interface with Operations** – This refers to the government activity that makes it difficult for the business to operate. Examples are government's encouragement of unionization, expression of negative comments about foreigners etc.

iv) **Social Strife** – Social strife can arise due to ethnic, racial, religious, tribal or civil tensions or natural calamities in any country. This leads to breakdown of the state machinery leading to economic disturbances.

Micro Risks – These are firm specific risks. These are:

i) **Goal Conflicts with economic policy** - Conflicts between objectives of MNCs and host governments have risen over issues like firm's impact on economic development, foreign control of key industries, sharing of ownership, influence on exchange rate etc.

ii) **Economic Policies and goal conflicts of the MNCs** – The economic policies of the govt are aimed at benefitting their own citizens. The policies through which these objectives are achieved may conflict with the goals of the MNCs.

Types of Country Risks

Country risk assessments are generally segregated into different categories, which take a closer look at some of the factors we mentioned prior. Let's discuss some this in more details:

i) **Political Risks** - Political risk determines a country's political stability, either internally or externally. For instance, a recent military coup would increase a nation's internal political risk for businesses as rules and regulations suddenly shift. Other risks in this category could include war, terrorism, corruption and excessive bureaucracy (i.e. host government red tape is preventing certain fund transfers or other transactions).Political risk can affect a country's attitude to meeting its debt obligations and may cause sudden changes in the foreign exchange market.

Macro Political risk affects all international businesses in the same way. For example ex-propriation, the seizure of assets with little or no compensation to the owners, terrorism, civil war, coup or military insurgence. Such risks may result in governments seizing the assets without compensation. Also, higher level of inflation or taxation, labour disputes and high crime levels are other factors which can adversely affect businesses.

Micro Political risks affect specific businesses. Example – the US decision to tax textile imports, Peru’s decision to nationalize its copper mines or India’s decision in 1975 to reduce foreign equity to 40.

ii) **Economic Risks** - Economic risk encompasses a wide range of potential issues that could lead a country to renege on its external debts or that may cause other types of currency crisis (i.e. recession). A major factor here is economic growth – the health of a nation's GDP and the outlook for its future. For instance, if a country relies on a few key exports and the prices for these are dropping, this creates a negative outlook and may increase the economic risk for foreign trading partners.

Acts of government may also impact economic risk, such as intervention in the money market or policy changes that cause tax instability. One other factor is issues with foreign currency exchange, for instance a shortage in certain currencies or a devaluation n of the exchange rate.

Types of Economic Risks

a) **Convertibility Risk** - This risk is an issue when a buyer has received the goods promised and is now ready to make payment but is unable to do because the buyer’s govt. bars the conversion of its local currency to that of any country.

b) **Foreign Exchange Risk**–This occurs when the rate of exchange between the seller’s currency and the buyer’s currency changes dramatically between the time the order is quoted and the time the final payment is received.

c) **Translation Risk** - Translation risk is the exchange rate risk associated with companies that deal in foreign currencies or list foreign assets on their balance sheets. Often times, a company that does business internationally or that holds assets in a foreign country will eventually have to exchange the foreign currency back into their country of domicile's currency. If exchange rates have fluctuated a large amount, this could lead to significant changes in the value of the foreign asset or income stream. This creates risk for the company because it can sometimes be difficult to tell how much the value of currencies are going to move relative to each other. The greater the proportion of a company's assets, liabilities or equities denominated in a foreign currency, the greater the company's translation risk. Translation risk would be much more transparently titled if it were called "currency exchange risk" instead.

iii) **Sovereign risk:** This is the risk that a foreign central bank will alter its foreign exchange regulations, significantly reducing or nullifying the value of its foreign exchange contracts. Analyzing sovereign risk factors is beneficial for both equity and bond investors, but perhaps more directly beneficial to bond investors. When investing in the equity of specific companies within a foreign country, a sovereign risk analysis can aid in creating a macroeconomic picture of the operating environment, but the bulk of research and analysis would need to be done at the company level. On the other hand, if you're investing directly into a country's bonds, evaluating the economic condition and strength of the country can be a good way to evaluate a potential investment in bonds. After all, the underlying asset for a bond is the country itself and its ability to grow and generate revenue.

3) **Sources of Funds** - Corporations often need to raise external funding, or capital funding, to expand their businesses into new markets or locations, to invest in research & development, or to fend off the competition. And, while companies do aim to use the profits from ongoing business operations to fund such projects, it is often more favorable to seek external lenders or investors. Despite all the differences among the thousands of companies in the world across various industry sectors, there are only a few sources of funds available to all firms. There are two sources of funds :

a) **Internal Sources of Funds** – These funds are generated within a parent – affiliate network. These are as follows:

i) **Equity Contributions**–This is the fund received in the form of equity. This is funded by the corporate itself.

ii) **Parent / Direct Loans** – Instead of increasing equity contributions, parent company may decide to provide investment funds to their foreign operations in the form of intra-company loans.

iii) **Parent Guarantees** – These are the guarantees provided by the parent company to their subsidiaries when the latter is not able to raise funds of its own.

iv) **Loans from Sister subsidiaries**–Internal financing is enhanced when another subsidiary which has extra funds provides a loan for this purpose.

v) **Global Cash Management**–This is the means of optimizing cash flows from any source globally.

b) **External Sources of Funds** – These are funds which are received from different financial and non- financial institutions. These are as follows:

i) **Debt Financing** – This is a major source of financing for international investments. This can be done through international bank loans (often called Eurocredit) or Eurobonds.

Eurocredit - Eurocredit refers to a loan whose denominated currency is not the lending bank's national currency. The concept is closely linked to that of eurocurrency, which is any currency held or traded outside its country of issue. For example, a eurodollar is a dollar deposit held or traded outside the U.S., and conversely, a eurocredit loan made by a U.S. bank would be one that is not denominated in USD.

The "euro-" prefix in the term arose because originally such currencies were held, and loans made, in Europe, but that is no longer solely the case and a eurocurrency can now be held or a eurocredit loan made anywhere in the world that local banking regulations permit.

Eurobond - A Eurobond is a debt instrument that's denominated in a currency other than the home currency of the country or market in which it is issued. Eurobonds are frequently grouped together by the currency in which they are denominated, such as eurodollar or Euro-yen bonds. Since Eurobonds are issued in an external currency, they're often called external bonds. Eurobonds are important because they help organizations raise capital while having the flexibility to issue them in another currency.

Issuance of Eurobonds is usually handled by an international syndicate of financial institutions on behalf of the borrower, one of which may underwrite the bond, thus guaranteeing the purchase of the entire issue.

ii) **Venture Capital** - Venture capital is a form of private equity and a type of financing that investors provide to startup companies and small businesses that are believed to have long-termgrowth potential. Venture capital generally comes from well-off investors, investment banks and any other financial institutions.

iii) **Equity Financing** - Equity financing is the method of raising capital by selling company stock to investors. In return for the investment, the shareholders receive ownership interests in the company.

iv) **Factoring** - Factoring is a financial service in which the business entity sells its bill receivables to a third party at a discount in order to raise funds. It differs from invoice discounting. The concept of invoice discounting involves, getting the invoice discounted at a certain rate to get the funds, whereas the concept of factoring is broader. Factoring involves the selling of all the accounts receivable to an outside agency. Such an agency is called a factor.

v) **Forfaiting** - Forfaiting is a means of financing that enables exporters to receive immediate cash by selling their medium and long-term receivables—the amount an importer owes the exporter—at a discount through an intermediary. The exporter eliminates risk by making the sale without recourse. It has no liability regarding the importer's possible default on the receivables.

vi) **Equipment Leasing** - Another way to keep equipment costs down is to lease instead of buy. These days, just about anything can be leased--from computers and heavy machinery to complete offices. The kind of business you're in and the type of equipment you're considering are major factors in determining whether to lease or buy. If you're just starting out and only need one computer, for instance, it probably makes more sense to buy. On the other hand, if you're opening an office that will have several employees and require a dozen computers, you may want to look into leasing.According to the Equipment Leasing Association of America, approximately 80 percent of U.S. companies lease some or all of their equipment, and there are some thousands of equipment-leasing firms nationwide catering to that demand.

Exchange Rate

Foreign Exchange - Foreign exchange, or forex, is the conversion of one country's currency into another. In a free economy, a country's currency is valued according to the laws of supply and demand. In other words, a currency's value can be pegged to another country's currency, such as the U.S. dollar, or even to a basket of currencies.A country's currency value may also be set by the country's government.

- Foreign Exchange (forex or FX) is a global market for exchanging national currencies with one another.
- Foreign exchange venues comprise the largest securities market in the world by nominal value, with trillions of dollars changing hands each day.
- Foreign exchange trading utilizes currency pairs, priced in terms of one versus the other.

Exchange Rate - An exchange rate is the value of one nation's currency versus the currency of another nation or economic zone.

Foreign Exchange Rate / FX Rate / Forex Rate - A foreign exchange rate is the price of the domestic currency stated in terms of another currency. In other words, a foreign exchange rate compares one currency with another to show their relative values. Since standardized currencies around the world float in value with demand, supply, and consumer confidence, their values change relative to each over time.

For instance, 1 US dollar in 2011 was worth about .68 Euros. In 2014, 1 US dollar is worth .75 Euros. This means the dollar has increased in value over this three-year span, but the Euro is still 25% more valuable.

Determination of Exchange Rate - An exchange rate is the price of one nation's currency in terms of another nation's currency. Like other prices, exchange rates are determined by the forces of supply and demand. Foreign exchange markets allocate international currencies.

Determination of Foreign Exchange Rate - The rate of exchange being a price of a national currency in terms of another, is determined in the foreign exchange market in accordance with the general principle of the theory of value, i.e., by the interaction of the forces of demand and supply. Thus, the rate of exchange in the foreign exchange market will be determined by the interaction between the demand for foreign exchange and the supply of foreign exchange.

The demand function for foreign exchange shows functional relationship between alternative rate of exchange and the corresponding amount of foreign exchange demanded. When the rate of exchange is low, the demand for foreign exchange tends to be high because there will be high inclination to import.

The supply function of foreign exchange represents the functional relationship between the rate of exchange and the amount of foreign exchange supplied. When rate of exchange is low, the demand for foreign exchange tends to be high because there will be high inclination of import.

The supply function of foreign exchange represents the functional relationship between the rate of exchange and the amount of foreign exchange supplied. When the rate of exchange is high, more foreign exchange is supplied as there will be more export due to high foreign demand. Equilibrium rate of exchange is determined at a point where demand for foreign exchange equals its supply.

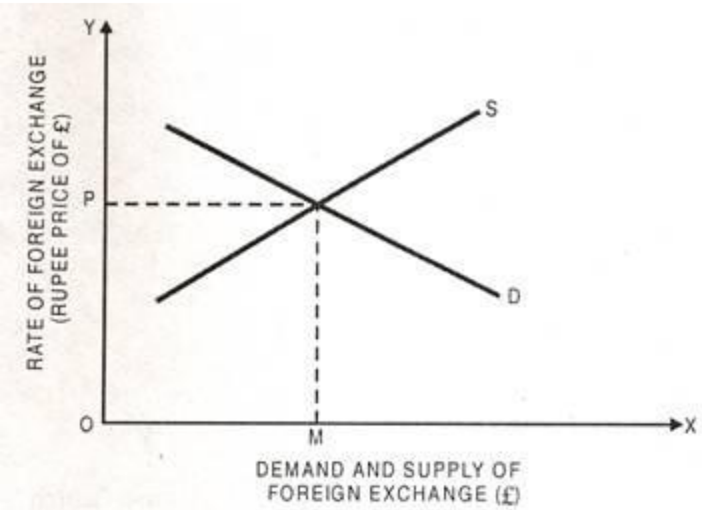


Fig. 1.

In the figure, OP is the rate of exchange determined at which OM is the demand as well as supply of foreign exchange. Any variation in demand or supply will lead to a variation in the rate of exchange.

Types of Exchange Rate / Risk Exposure

There are 3 types of exchange risk exposure. These are:

i) Transactionexposure

The transaction exposure component of the foreign exchange rates is also referred to as a short-term economic exposure. This relates to the risk attached to specific contracts in which the company has already entered that result in foreign exchange exposures.

ii) Translation Exposure

Translation exposure of foreign exchange is of an accounting nature and is related to a gain or loss arising from the conversion or translation of the financial statements of a subsidiary located in another country. A company such as General Motors may sell cars in about 200 countries and manufacture those cars in as many as 50 different countries.

A company with subsidiaries or operations in foreign countries is exposed to translation risk. At the end of the financial year the company is required to report all its combined operations in the domestic currency terms leading to a loss or gain resulting from the movement in various foreign currencies.

iii) Economic exposure

Economic exposure is a long-term effect of the transaction exposure. If a firm is continuously affected by an unavoidable exposure to foreign exchange over the long-term, it is said to have an economic exposure.

Exposure to foreign exchange results in an impact on the market value of the company as the risk is inherent to the company and impacts its profitability over the years. A beer manufacturer in Argentina that has its market concentration in the United States is continuously exposed to the movements in the dollar rate and is said to have an economic foreign exchange exposure.

Exchange Rate Risk and management - Exchange rate risk, or foreign exchange (forex) risk, is an unavoidable risk of foreign investment, but it can be mitigated considerably through hedging techniques. To eliminate forex risk, an investor would have to avoid investing in overseas assets altogether. However, exchange rate risk can be mitigated with currency forwards or futures.

Exchange Rate Risk Management Framework

Risk Management Framework

1) **Forecast** – After determining the exposure, the first step for a firm is to develop a forecast on the market trends and what the main direction is going to be in the near future.

2) **Risk estimation** - Based on the forecast a measure of Value at Risk (VaR) and probability of this risk is ascertained. This includes market-specific problems like liquidity and system specific problems like reporting gaps.

3) **Benchmarking** – Based on the exposures and risk estimates, the firm decides whether to manage on a cost-centre or profit-centre basis. A cost centre approach is a defensive one where the main aim is to see that the cash flows are not affected adversely beyond a certain point. A profit centre approach is a more aggressive approach where the firm decided to generate a net profit over a period of time.

4) **Hedging** – Post benchmarking, the firm decides the appropriate hedging strategy based on the company specific requirements. These could be futures, forwards, options, swaps and issue of foreign debt.

5) **Stop Loss** – These are arrangements which need to be there in order to rescue the firm in case the forecasts turn out to be wrong.

6) **Reporting and review**–Risk management policies are typically subjected to review based on periodic reporting. These reports are profit/loss status, exchange / interest rate achieved etc.

Methods of Foreign Exchange Risk Management (FERM)

Many methods are available to cover or hedge exposure to risk. These could be external hedging tools or internal hedging tools.

External Hedging Tools for FERM - There are 4 major external techniques of FERM. These are:

1) Futures Contracts- A futures contract is an agreement between a buyer and a seller to trade a certain asset on a date that's predetermined by those involved in the transaction. The contract includes a description of the asset, the price, and the delivery date.

Futures are traded publicly on exchanges, and for that reason, they are highly regulated in the U.S. by the Securities and Exchange Commission. Because they are regulated, there is also no risk of either party defaulting on their obligation.

Futures are a very liquid type of derivative, meaning they're easily bought and sold, and investors can generally get into and out of futures positions rapidly.

2) **Forwards Contracts -** A forward contract is similar to a futures contract, but it is not publicly traded on an exchange. Forwards are private agreements between a buyer and a seller. And since forwards are privately traded, they are typically unregulated as well, so there's a risk either party to a contract may default.

One big advantage forwards have over futures is they can be customized to fit the exact needs of the buyer and seller, while futures are standardized to, for example, involve the exchange of exactly 5,000 bushels of corn.

3) **Swap Contracts -** A swap is a contract between a buyer and a seller to exchange multiple cash flows at preset future dates. The value of these cash flows is determined by a dynamic metric such as an interest rate, with one party receiving a set amount on each date and the other an amount that varies according to, for example, changes in the London interbank offered rate (LIBOR).

4) **Options Contracts -** There are two types of options: calls and puts. A call option confers the right, but not the obligation, to buy a certain asset on or before an expiration date at a certain price. For example, the buyer of the call may be able to buy 100 shares of XYZ Corp. on or before the contract's expiration date at a price of $25 a share from the seller of the call. If the stock price rises above $25, the buyer would want to exercise their call option and buy the shares. If the stock price falls to $10, the buyer wouldn’t exercise their right to do so because they could buy the shares for less money on the open market.

A put option is the opposite of the call option. In this case, the buyer of the put has the right to sell 100 shares of XYZ at $25 each. If the stock price falls to $10, the buyer of the put would exercise their option to sell each of the 100 shares to the seller of the put for $15 more than its current value. If the stock price rises above $25, the buyer wouldn't want to sell the stock to the seller of the put for less than they could receive on the open market, so the buyer would let the put expire worthless.

Internal Hedging Tools for FERM - These are as follows :

1) **Netting** - Netting implies offsetting exposures in one currency with exposure in the same or another currency, where exchange rates are expected to move high in such a way that losses or gains on the first exposed position should be offset by gains or losses on the second currency exposure. It is of two types bilateral netting & multilateral netting. In bilateral netting, each pair of subsidiaries nets out their own positions with each other. Flows are reduced by the lower of each company’s purchases from or sales to its netting partner.

2) **Matching** - The netting is typically used only for inter company flows arising out of groups receipts and payments. As such, it is applicable only to the operations of a multinational company rather than exporters or importers. In contrast, matching applies to both third parties as well inter-company cash flows. It can be used by the exporter/importer as well as the multinational company. It refers to the process in

which a company matches its currency inflows with its currency outflows with respect to amount and timing. Receipts generated in a particular currency are used to make payments in that currency and hence, it reduces the need to hedge foreign exchange risk exposure.

3) **Leading & Lagging** - It refers to the adjustment of intercompany credit terms, leading means a prepayment of a trade obligation and lagging means a delayed payment. It is basically intercompany technique whereas netting and matching are purely defensive measures. Intercompany leading and lagging is a part of risk-minimizing strategy or an aggressive strategy that maximizes expected exchange gains. Leading and lagging requires a lot of discipline on the part of participating subsidiaries. Multinational companies which make extensive use of leading and lagging may either evaluate subsidiary performance in a pre-interest basis or include interest charges and credits to overcome evaluation problem.

4) **Pricing Policy** - In order to manage foreign exchange risk exposure, there are two types of pricing tactics: price variation and currency of invoicing policy. One way for companies to protect themselves against exchange risk is to increase selling prices to offset the adverse effects of exchange rate fluctuations. Selling price requires the analysis of Competitive situation, Customer credibility, Price controls and Internal delays.

5) **Invoice in Home Currency** − An easy way is to insist that all foreign customers pay in your home currency and that your company pays for all imports in your home currency.

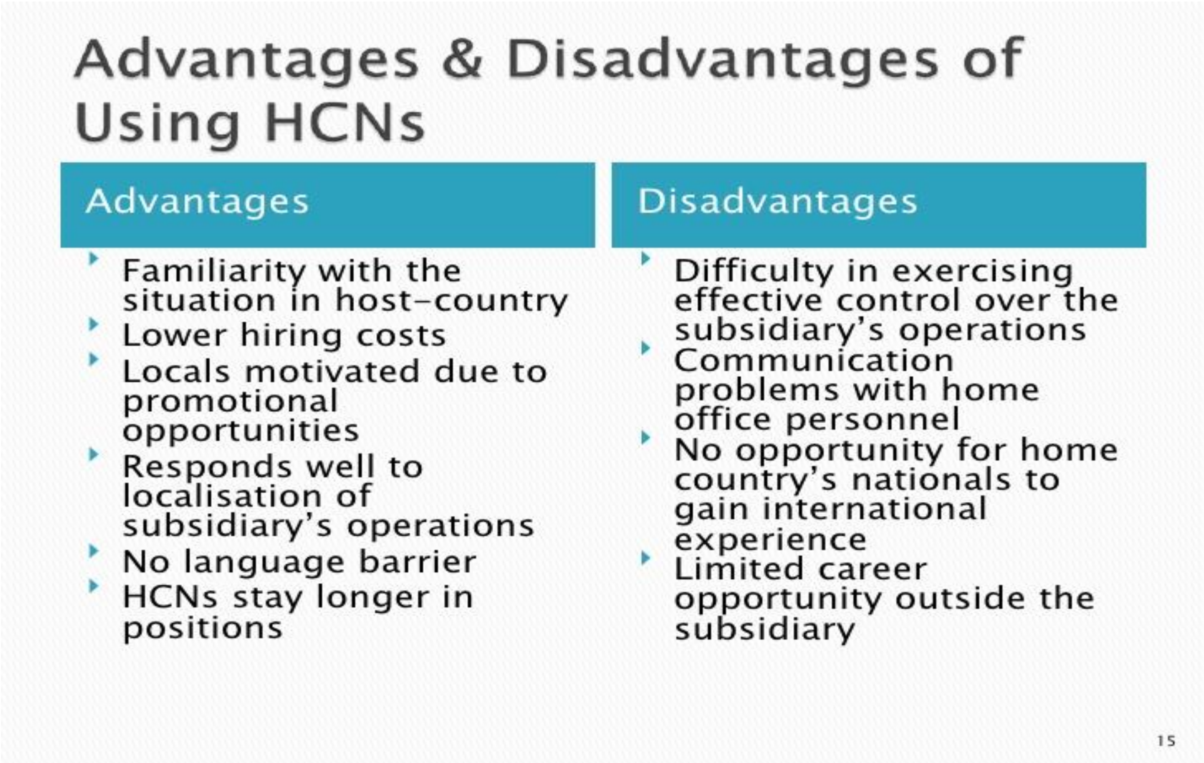
Expatriates Management

Expatriate - Expatriates are employees of organizations in one country who are assigned to work in other countries on long- or short-term business projects.

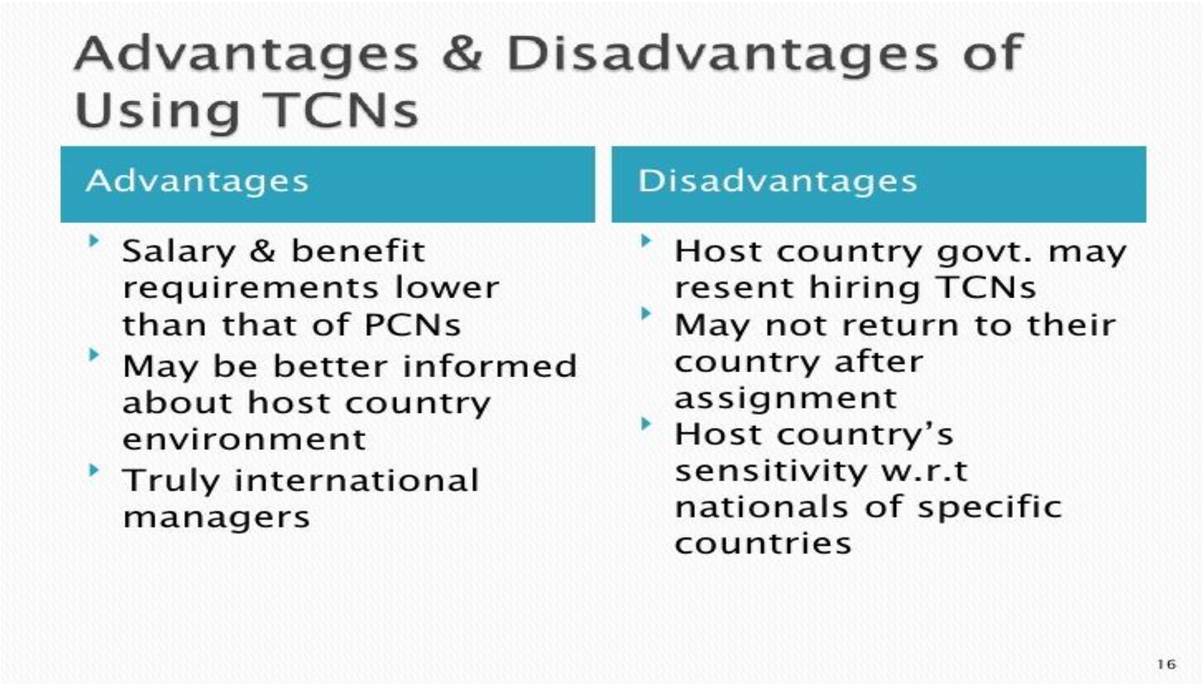
The firm is normally referred to as the parent company, while the country of employment is known as the host country. If General Motors sent one of its U.S. executives to oversee a new development in Brazil, the executive would be an expatriate, General Motors would be the parent company, and Brazil would be the host country. Equally, if an employee from Brazil was sent to the U.S. or an employee from Canada were sent to the People's Republic of China, they would be expatriates.

Types of Expatriates - Expatriates can be either Parent Country Nationals (PCNs), Third Country Nationals (TCNs) or Host Country Nationals (HCNs).

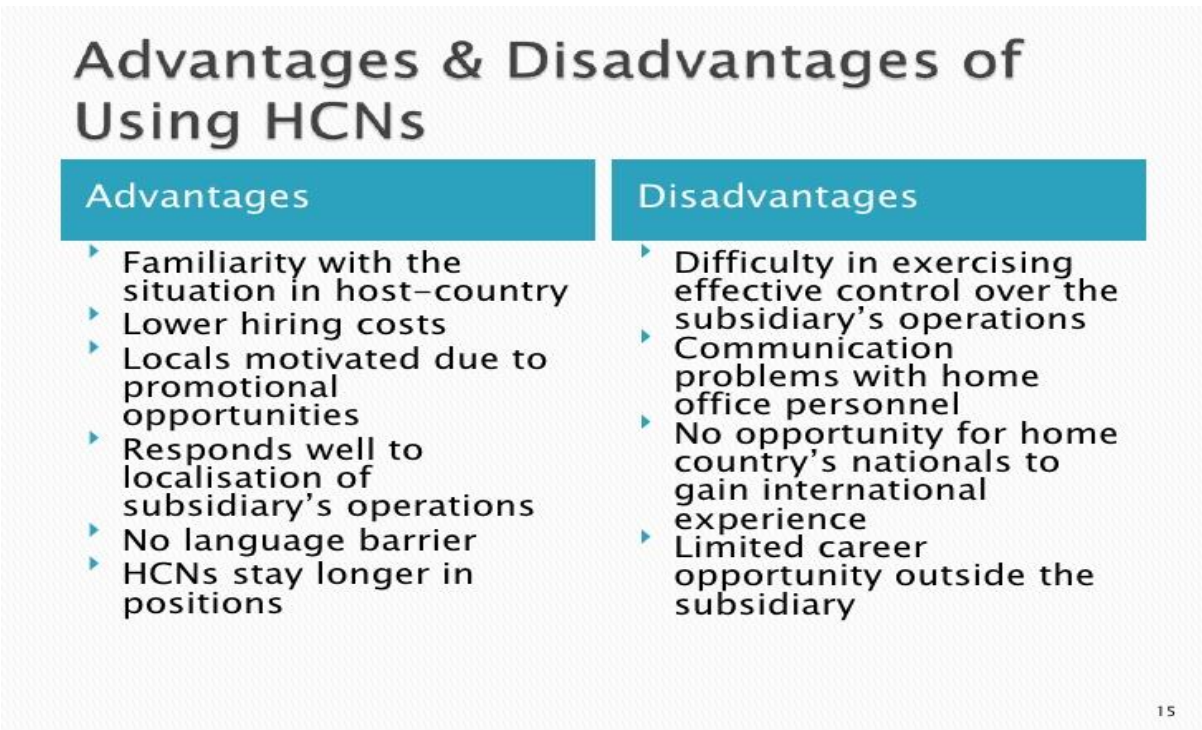
Parent Country Nationals (PCNs) - a PCN is a person whose nationality is the same as that of the firm, but different from the country in which they are working: for example, a Japanese manager working for a UK-based subsidiary of a Japanese company.



Third Country National (TCN) - In an international firm, a TCN is a person whose nationality is different from that of the firm, and of the country in which the firm is operating: for example, a UK manager working for an Australian-based subsidiary of a Japanese company.



Host Country Nationals (HCNs) -In an international firm, an HCN is a person whose nationality is the same as that of the country in which the company is operating: for example, a UK manager working for a UK-based subsidiary of a Japanese company.



Functions of expatriates

i) Help their companies in establishing operations in other countries

ii) Enter overseas markets or transfer skills and knowledge to their companies' business partners

iii) Helps organizations develop their management skills base and their ability to succeed in a global marketplace.

For an individual, an expatriate position has the following advantages:

i) Opportunities for personal and professional development

ii) A higher salary (often comparative to the local cost of living)

iii) A good life experience

iv) Greater employability for future assignments

Guidelines for Expatriate Management

1. Design a clear job description with minimum role conflict.

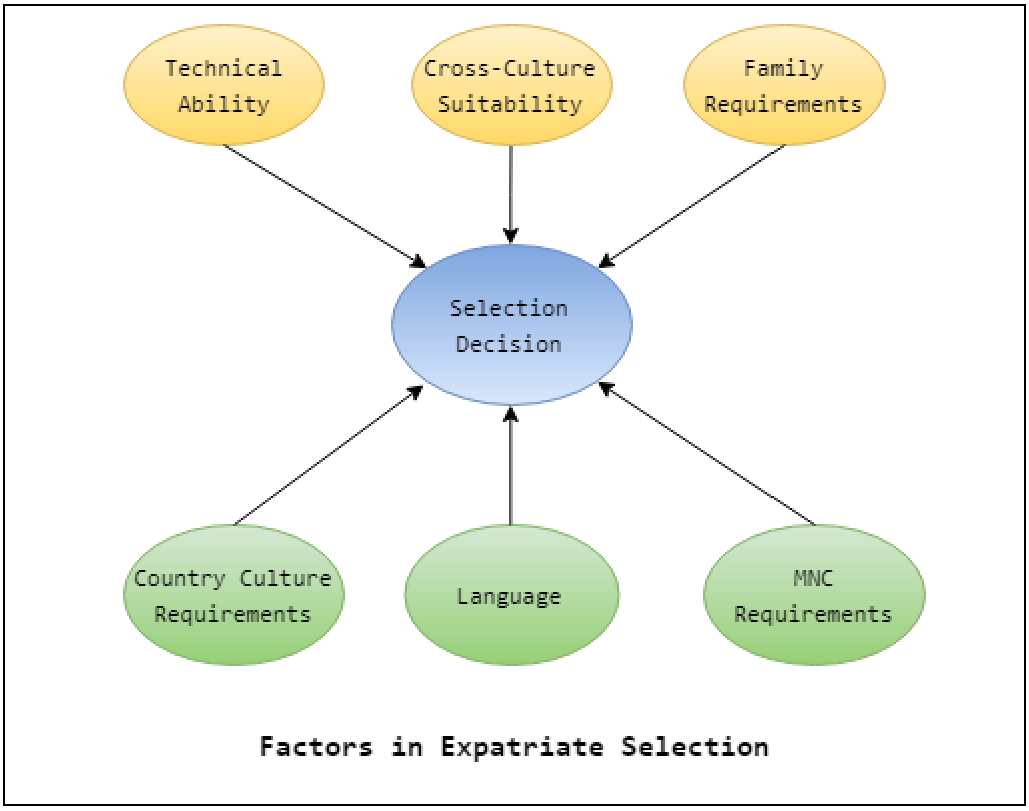
2. Clear cut measures of selection.

3. Proper & frequent coordination and communication.

4. Training and orientation support services.

5. Open problem sharing and feedback forums.

Selection of expatriate managers



i) **Technical ability** - It refers to the ability of a person to perform the required tasks. International firms place heavy reliance on relevant technical skills during the expatriate selection process.

ii) **Cross Cultural** suitability - It includes adjustability of the expatriate to operate in a new environment. Cultural ability required include cultural empathy, adaptability, diplomacy, language ability, positive attitude, emotional stability and maturity.

iii) **Family Requirement** - This refers mainly to the adjustment of spouse.

iv) **Country/ cultural requirements** - Certain countries or regions are considered "hardship postings'' - remote areas away from major cities or modern facilities, or war-torn regions with high physical risk. There may be reluctance to select females for certain middle east or south east Asian regions. Some countries do not issue permit for a females for a female.

v) **MNC requirements** - This influences expat selection. Duration of the assignment and philosophy of staffing are the two certain that are crucial in this context.

vi) **Language skills** - This also decide on exact selection. When we say languages, we refer to the language of the host country. Knowledge of the host country language adds to the performance of the expat.

The final step in improving the selection process of an expatriate is to use appropriate tests to select or reject aspirants. Generally, personality and psychological tests are used in the selection process, but the effectiveness of such tests is questioned. Many HR managers tend to equate domestic performance with overseas performance potential. But the two are not same. An executive who performs well in domestic settings may not be adept to managing in a different cultural environment.

Expatriate Training & Development

An expatriates success depends on how fast they 'Acculturate' (absorb) in the host country. In expatriate training the focus is on ascertaining the cultural awareness of the individual, his / her 'fit' for the host country's culture, how similar/ dissimilar is the culture of the expats' culture from that of the host country.

Types of Expatriate Training

Training for PCN's & TCN's:

a) **Cross Cultural Training (CCT)**- Cross cultural training may be understood as any planned intervention to increase the knowledge and skills of the expatriates to live and work effectively in a unfamiliar host country and culture.

Effectiveness of CCT - The cognitive, affective and behavioral changes that occur during and after the training. A successful CCT insures several benefits to the business. It also has a few drawbacks.

Merits

i) Increase changes of success in global assignments.
ii) Provides a comprehensive global perspective for the manager.
iii) Instills a sense of confidence in the expatriate.
iv) Foreign employees can be managed better.
v) Reduces culture shock due to exposure to the host country.

Demerits

i) Develops a false sense of confidence among employees.

ii) May not remove cultural biases and prejudices.

iii) May not be taken seriously by the recipient.

iv) May not make a visible difference to business volume.

v) Can never fully prepare an assignee to face the real-life challenges

b) **Language Training -** English is the global business language. The expat has to be knowledgeable in the host country's language, skills & corporate etiquettes etc.

c) **Diversity Training** – This is gaining utmost important in this globalization era. It is very important to be culturally knowledgeable and the aim is to provide training to the managers in order to change their behavior in terms of racism, sexism etc.

The components of diversity training are:

- **Attitudes**: Understanding your own attitudes Understanding different attitudes Openness to cultural difference Skills: Cross-cultural communication Problem – solving Teamwork Leadership
- **Knowledge**: Company policy and procedures. Professional standards
- **Emotions**: Recognize emotions Managing emotions productively

Other related issues in Training:Social & Cultural Relation between two countries, Values, beliefs & priorities, geography, religion & its role and language.

Training Methods - Short lectures, Role plays, Self-reflection & Assessments, Group discussion, Group problem-solving activity, Question & answer

d) **Home Country Training** - Home country national contribute significantly in MNCs, performance. To train for better performance, training is often given at the local levels. Ex- The Indian company, Infosys provides training to its US and UK. HCN's also provides with international training, either in parent country, headquarter or home-subsidiary operations. It also aims to improve the adjustment skills of HCNs and better understanding of the corporate culture and language training.

Career Development for Expatriates

a) Pre-departure training

b) On-site training

c) Cultural training

d) Language training

e) Practical training

Expatriate Compensation

Components of Remuneration Package

i) **Base salary** – It is the amount that the expatriate normally receives in the home country. This is set as per the salary structure of the home country.

ii) **Benefits** – Some of the common benefits are :

a. **Housing** – It depends on the company policy and covers a wide range of arrangements. Some allow for a well-furnished residence, some give a predetermined housing allowance and in some cases expats arrange for their own residence.

b. **Utilities** – This includes AC, gas, electricity, telephone, Mobile expenses

c. **Car** – Depending on the status of the employee, a car and sometimes a driver is provided.

d. **Helpers** – At times servants, gardeners, security, house help etc is provided by the company.

e. **Educational Benefits** – These cover costs such as tuition, enrolment fees, books, supplies, transportation etc for the children.

iii) **Allowances**–The different types of allowances given to expatriates are as follows:

a. **Cost of Living Allowances** - Cost of living allowances (COLAs) enable expatriates to maintain their standard of living. COLAs are given when the cost of living in the host country is greater than that in the home country.

b. **Relocation Allowances** - The allowance makes up for any mistakes made in any of the other allowances for unforeseen complications. Expatriates receive about one month's salary.

c. **Foreign Service Premiums** - This is a sum of money that is simply a reward for being willing to move one's family to a new country. The sum is generally a percentage of one's base salary—usually between 10 to 25 percent.

d. **Hardship Allowance** - The hardship allowance is actually another foreign service premium added to the original one. It is based on not just having to go overseas, but where you go overseas. Hardship allowances are greatest when the expatriate is sent to places having poor living conditions, a vastly different culture, less access to good health care, etc.

e. **Home Leave Allowances** - Companies usually provide expatriates and their families with round-trip, business-class airfare to visit the home country at least once a year.

f. **Club Membership Allowances -** In some countries the only way an expatriate can gain access to recreational facilities (e.g., tennis courts, swimming pools, country clubs) is by joining clubs. Also, in many cultures these facilities are important places in which to develop contacts and conduct business. This type of allowance is usually made on a case-by-case basis.

iv) Incentives - These are latest schemes being designed by companies to keep them motivated overseas.

Repatriate Management

Repatriation is a process of returning back from an international assignment to a home country after completing the assignment or some other issues. Repatriation is the last step in the expatriation cycle and it involves readjustment and re-entry of international managers and their families back to their home country.

This is also very important, because there can be difficulties in returning to the home country Returnees experience a reverse culture shock and this time it can be more severe than when meeting the host country and culture. Expats repeatedly cite repatriation as the area of highest dissatisfaction with respect to organizational policies.

Process of Repatriation

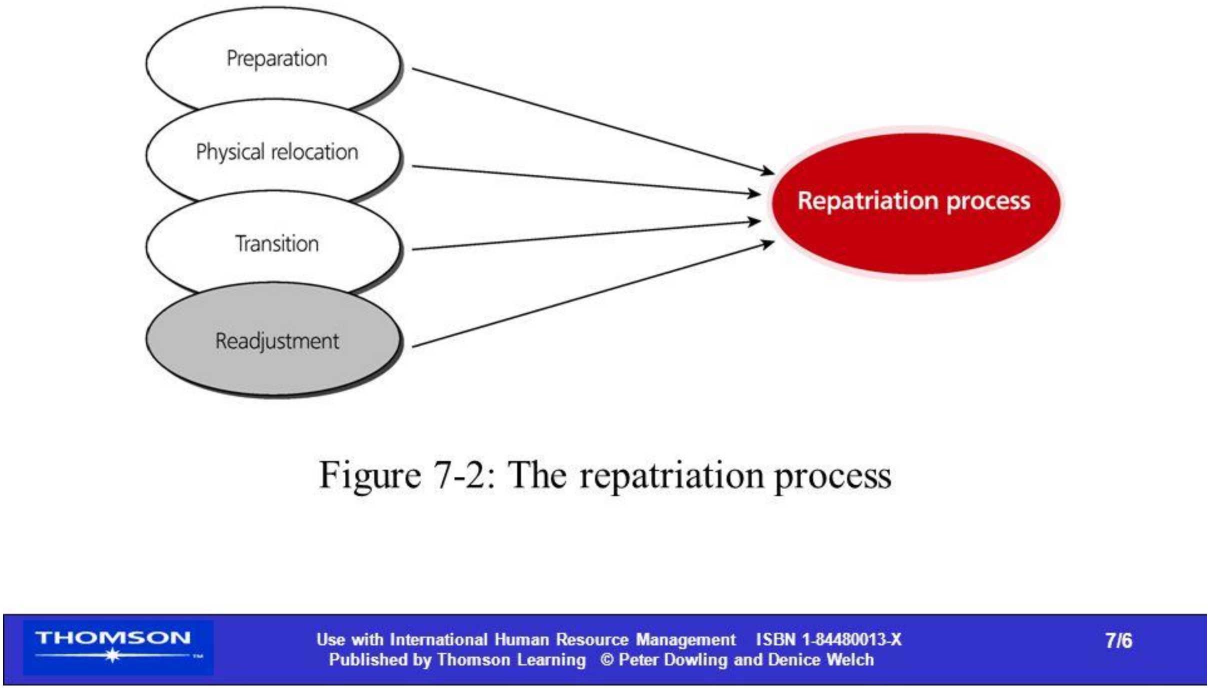


Figure 7-2: The repatriation process

1. **Preparation**: before 3-4 months of expatriate return

- Developing plans for future and info about new position
- Checklist of items before leaving (closure of bank a/c, bills etc.)

2. **Physical Relocation:**

- Removal of personal belongings, breaking ties with friends, colleagues before returning
- Re-entry training for home country's update, socio-cultural contrast orientation, psychological aspects etc.

3. **Transition:**

- Finding accommodations, school for children, opening bank A/c etc. for comfortable living.
- Relocation consultants used.

4. **Readjustment:**

- Coping with aspects as company changes , reverse culture shock and career demands
- Eg. Repatriate returning from country where power distance is large as Thailand may experience stress on returning to small power distance countries like Denmark.

Successful repatriation depends on meaningful reintegration after coming back to their home culture, since staying abroad changes one's mindset and day to day behaviour, both socially and professionally. Training repatriates to re- negotiate back physically to their home culture is a must.One of the reason for professionals leaving their organization is related to undervaluing of their knowledge on return to their organization. Steps need to be taken to alter this trend. The organization also has to deal with reverse culture shock.

Transferring knowledge: Through a various of methods, such as, in an informal and just-in-time basis on projects or discussions with the boss, or during special meeting, the repatriates may be given an opportunity to share their knowledge and experiences gained abroad. The repatriate can serve as a mentor to other expatriates going to the same country and through such information exchange ensure a smooth entry of their colleagues to the foreign countries, due to prior knowledge and experiences, gained abroad.