MP-111

Vardhaman Mahaveer Open University, Kota

Global Business Management

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Global Business Management

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Unit - 1 : International Business : An Overview

Unit Structure:

1.0 Objectives

After studying this unit you will be able to understand:

- Meaning and significance of international business,
- Motives for Internationalisation of business,
- Different types of decisions taken by the international firms, and
- Reasons for the growth of international business.

1.1 Introduction

International Business conducts business transactions all over the world. These transactions include the transfer of goods, services, technology, managerial knowledge, and capital to other countries. International business involves exports and imports. International Business is also known as Global Business.Daniels and Radebaugh defined international business, "as all commercial transactions-private and governmental-between two or more countries. Private companies undertake such transactions for profit; governments may or may not do the same in their transactions. These transactions include sales, investments, and transportation. Thus, international business comprises a large and growing portion of the world's total business. Today, global events and competition affect almost all companies-large or small-because most sell output to and secure supplies from foreign countries. Many companies also compete against products and services that come from abroad. In other words, a company operating in the international business field will engage in modes of business, such as exporting and importing, that differ from those operating on a domestic level. To operate effectively, managers must understand these different modes.

The importance of international business in the 21st century has increased tremendously. The fact is that international business makes it possible for us to have the quality goods and services available at the prices we are willing to pay. International business is gaining increasing importance because it comprises a large and growing portion of the world's total business. International business is important as it creates a suitable ground on which companies can expand their markets and operations. This is attributed to the fact that no country can stand alone without having to engage in trans-border transactions hence, there is need to include the neighbouring countries, as well as, the international community. This will lead to a wider market for goods and an even wider source of raw materials essential for producing the products that are altered or exported.

The increased levels of globalisation have also led to elevate international business as more people are getting involved in multinational corporations. In this respect, the investors often open subsidiary branches of their companies in other countries hence, their transactions are carried out across the borders. Consequently, improved communication by introduction of the Internet has generated increased interest in the ability to transact business across continents without having to shift the locality in terms of being mobile. Hence, it becomes even easier to locate business enterprises where it is more likely to attract more profits and this could be in foreign countries.

Every company is trying to expand its business by entering foreign markets. International business helps companies grow geographically. Geographic expansion may be used as a business strategy. Even though companies may expand their business at home. International business helps companies in managing product life cycle of their products. Every product has to pass through different stages of product life cycle-when the product reaches the last stages of life cycle in present market it may get proper response at other markets. Companies having outstanding technology advantages gain through the achievement of core competency. This technology helps the company in capturing other markets. Business opportunities in overseas markets help in expansion of many companies. They might have reached a saturation point in domestic market.

It results in the proper use of resources available with the firms like labour, minerals etc. but are not productively utilized. Further, the international business makes availability of quality products when markets are open. Foreign companies will market latest products at reasonable prices. Also the firms doing international business earning foreign exchange may be used for strategic imports. India, in particular, needs foreign exchange to import crude oil, defence equipment, raw material and machinery. In International business countries depend upon each other for meeting their requirements. India depends on gulf countries for its crude oil supplies. International business necessitates proper development of infrastructure. A company entering international business must invest in sufficiently in infrastructure.

1.2 Characteristics of International Companies

Companies that do business across borders face a specific set of challenges and opportunities that domestic companies do not. While each business is unique, all of them must confront many of the same challenges. As such, these companies have developed a few standard ways of managing risks and doing business internationally. Those adaptations have created a set of common characteristics for international businesses as discussed below:

- **Cross-Cultural Management**

Besides trying to get different personalities to work together, international companies must also deal with cultural differences, language barriers, differing holidays, conflicting laws and multiple time zones. International companies often employ country managers that are trained in international management, as well as liaisons specifically tasked with making sure that international communication runs smoothly. They may also employ psychological profiling tools such as the cultural orientation Indicator to identify potential culture clashes before they happen. Some keep international calendars to alert everyone in the company that the European Union staff will be on vacation in August, the Moon Cake Festival will shut down tin box production in China, and Canadian employees will go for thanks giving in October.

● **Supply Networks**

International companies may be more interconnected with their suppliers and distributors than domestic companies. This may be due to a more complex product line, the necessity of real-time communications to accomplish complicated manufacturing, or close personal connections. In some countries, local laws force international companies to partner with locally owned companies. In addition, many larger international companies grow primarily through acquisition. For instance, a Chinese company that wants to expand into Brazil may find it easier to buy a Brazilian company than to start operations from scratch. This can further expand the network of suppliers and distributors. Those relationships and contacts may also be the most valuable part of the acquisition.

● **Foreign Exchange**

Finance is critical to the health of any business, but an international company must pay particular attention to its finances. International companies work in multiple currencies and are often taxed in multiple locations. A timing error when paying a bill in Japan with revenues from France can result in a net loss on a project due to fluctuations in currency values. Conversely, a wise business decision can allow an international company to profit from a much lower cost of doing business due to a favorable exchange rate.

1.2.1 International Versus Domestic Business

International business has been the outgrowth of domestic business. Almost every big corporation such as Honda, Mitsubishi and Toyota began their operations in the domestic market before expanding into the international market. Several Indian pharmaceutical firms like Ranbaxy, Dr.Reddy's Lab also started operations domestically before making their foray in the international market as an exporter. As a firm increases its scale of operations it enters into international market. Although international business is an extension of domestic business, yet there are significant differences between the two: business firms face risks on account of the unpredictability of operational and financial outcomes. International business firms operate in situations of increased risk arising out of the multiplicity and diversity of their working environment. International corporations work in multiple financial environments, receive payments in different currencies, and deal with harmonization of firm accounts from subsidiaries in different countries. Market supply and demand conditions in the domestic market differ significantly from the international market. There are some of the differences and complexities, which create more opportunities as well as more risks and uncertainties for international business firms.

1.2.2 Why Should Companies Engage in International Business?

Daniels and Radebaugh have given four reasons why companies engage in international business. They emphasized that a company operating internationally should consider its mission, objectives and strategy.

- **To Expand Sales:**

Companies' sales are dependent on the consumers' interest in their products or services and the consumers' willingness and ability to buy them. The number of people and the amount of their purchasing power are greater for the world as a whole than for a single country, so companies may increase their sales by reaching international markets. Increased sales are a major motive for a company's expansion into international business. Many of the world's largest companies like BASF, Electrolux, Gillete, Nestle, Philips and Sony derive more than half of their sales from outside their home country. However, smaller companies may also depend on foreign sales.

- **Acquire Resources:**

Manufacturers and distributors also look for products, services and components produced in foreign countries. They also peep for foreign capital, technologies, and information that they can use at home country. Sometimes, they do this to reduce their costs. Sometimes, a company operates abroad to acquire something not readily available in its home country. Acquiring resources may enable to company to improve its product quality and differentiate itself from competitors and potentially increasing market share and profits. Although a company may initially use domestic resources to expand abroad, once the foreign operations are in place, the foreign earnings may then serve as resources for domestic operations.

- **Diversify Sources of Sales and Supplies:**

To minimize swings in sales and profits, company may search for foreign markets to take advantage of recessions and expansions. Sales decrease in a country that is in a recession and increase in such a country that is expanding economically. By obtaining supplies of the same product or component from different countries, companies may be able to avoid the full impact of price fluctuations in any one country.

- **Minimize Competitive Risk:**

Many companies enter into international business to counter advantages competitors might gain in foreign markets that could hurt them domestically.

1.2.3 Orientations of International Organizations

Perlmutter identified distinctive "orientations" of management of international organizations. His 'EPRG" scheme identified four types of attitudes or orientations associated with successive stages in the evolution of international operations.

1. Ethnocentrism:

In ethnocentric orientation, home country is considered to be superior. Further, the manager looks for similarly in the foreign market. He supposes that products and processes that have succeeded in the home country would also succeed abroad and should therefore be used.

In the ethnocentric orientation foreign operations are viewed as secondary to domestic operations and primarily as a means of disposing off 'surplus' domestic production. Plans for overseas markets are developed in the home office, utilizing policies and procedures identical to those employed in the domestic market. An export department or international division, and the marketing personnel most commonly administer overseas marketing by an export department or international division. The ethnocentric position appears to be appropriate for a small company just entering international operations, or for companies with minimal international commitments because this approach entails a minimal risk and commitment to overseas markets - no international investment is required and no additional selling cost incurred, with the possible exception of higher distribution costs.

2. Polycentrism:

As the company begins to recognize the importance of inherent differences in overseas markets, a polycentric attitude emerges. The prevalent philosophy at this stage is that local personnel and techniques are best suited to deal with local market conditions. Subsidiaries are established in overseas markets and each subsidiary operates independently of the others and establishes its own marketing objectives and plans. In polycentric orientations the manager recognizes that each country is unique. To succeed abroad, such uniqueness has to be respected and addressed in the company offerings. The centralized structured as favored in the ethnocentric culture is found to be not appropriate structure. In this orientation local operations are given more autonomy. Subsidiaries are setup with operational independence.

3. Regiocentrism:

A regiocentric company views different regions as different markets. A particular region with certain important common marketing characteristics is regarded as a single market, ignoring national boundaries. Objectives are set by negotiation between headquarters and regional HQ on the one hand and between regional HQ and individual subsidiaries on the other.

4. Geocentrism:

A geocentric company views the entire world as a single market and develops standardized marketing mix, projecting a uniform image of the company and its products, for the global market. Geocentric business practices are neither home operation's nor the host country company's but a hybrid of the two. A company follows a geocentrism approach when it bases its operations

1.3 Motives for Internationalisation

Dunning introduced a model of Internationalisation motives including four different categories of motives. These categories are market seeking, resource seeking, efficiency seeking and strategic resource seeking motives and network seeking motives. Dunning explains how market and resource seeking motives have been the two most recognized categories of motives before. These two categories still correspond to most first time Internationalisations by firms. Overall, efficiency seeking and strategic asset seeking motives increase in significance and are more common as motives for companies already engaged in multinational activity. He also shows that closer relations with customers and durable relations with suppliers were important motives. Furthermore, the Internationalisation was more driven by opportunities rather than threats. Karagozoglu and Lindell showed that opportunities in foreign markets and inquiries from foreign buyers were the top two motives for Internationalisation. Insufficient domestic sales compared to R&D costs were also a significant motive. Francis and Collins-Dodd claimed that for high-tech SMEs relationships and sales contacts in foreign markets are the best way for improving sales abroad. They also stress the importance of strategic alliances partners in order to improve foreign market performance. In other words, networking is vital. Freeman et al. identify several variables that increase the rate of Internationalisation of SMEs. Such variables are a small domestic market, unique knowledge or technology, and different forms of relationships and alliances.

1. Market Seekers:

This category of motives focuses on demand aspects. If decision makers within a company acknowledge the importance of accessing specific target markets abroad and believe that a direct presence internationally is essential for this access they will focus on market seeking motives. Companies that invest in a particular country or region with the intention to supply goods and services are called market seekers. According to Dunning there are several reasons why companies undertake such action.

Firms sometimes conduct investments on foreign markets to promote or exploit new markets. Reasons may include the sheer size of the market or an expected growth of the same, indicating that the company may enter and then generate profit. Products and services may have to be adapted to tastes, needs and trends on a particular market. A direct presence on a local market may be necessary, as companies that are not close to markets may have a disadvantage in adapting services and goods. Companies may act as a part of a global production and marketing strategy and seek a physical presence on leading markets where the competitors are. Companies may follow their competitors, or more aggressively advance in expanding markets by investing there.

Foreign governments can also encourage investments from companies in other countries. Incentives such as subsidized labour and trade barriers may tempt companies to invest in these countries. Much of government export- promotion policies focus on encouraging entrepreneurs to internationalize using business education and training. This fosters direct trade links in other countries, and financial incentives. Sometimes a firms' home market is limited, i.e. by not bringing the firm enough revenues. Such limitations can be a saturated market, a too competitive market, not enough customers, and so on. Many companies there go to other markets, including foreign markets.

2. Resource Seekers:

The resource seeking companies are those investing abroad in order to obtain resources (Dunning, 1993). Perhaps the wanted resource can be acquired at a lower comparative cost, or simply does not exist at all in the home country. Resource seeking could deal with the search for physical resources, such as minerals (oil, zinc, copper etc.) and agricultural products (rubber, tobacco, sugar etc.). These resources are sometimes central to the survival of a company, especially if the material constitutes an important part of the production. The search for cheap and unskilled (or semi-skilled) labour is an important activity for many companies trying to minimize costs and maximize profits. This labour force should be well motivated and exist in large numbers. The seeking for such labour is often undertaken by manufacturing companies with high real labour costs.

Sometimes skills and capabilities are resources that can be used through collaboration with a business partner. According to Dunning's model (1993) this corresponds to resource seeking. We believe that collaboration involves the use and development of business relationships and networks. Therefore, we put this kind of collaboration under the category of network seeking motives.

3. Efficiency Seekers:

Another category of motives focuses on efficiency (Dunning, 1993). The purpose is to rationalize structures of established investments in order to gain fromcommon governance. Often those benefits come from economies of scale and scope, but also risk diversification. Therefore, efficiency seeking is seen as gaining from the differences of factor endowments, cultures, institutional arrangements, and economic systems etc. Often this implies concentration of production in a limited number of places. Companies that are seeking efficiency are often experienced, large and diversified multinational enterprises. Advantage can be drawn from differences of factor endowments in different countries. Such differences consist of availability and cost. As an example, value-adding activities that are capital, technological or informational intensive are usually placed in developed countries. On the other hand, value-adding activities that are labour or resource intensive are often placed in developing countries.

Economies of scale and scope are issues that an efficiency seeker often focuses on. While differences of factor endowments utilize differences between developed and developing countries, economies of scale and scope regard differences within similar countries. The differences may be that of consumer tastes and supply capabilities. Companies may become international with the intention to lower the total amount of tax paid to governments. By acting in several countries the efficiency seeker might be able to lower the tax burden. Exactly how this is done is not of interest to this study. However, we believed this was a motive well worth investigating.

4. Strategic Resource Seekers:

Strategic resources are intangible resources dealing with the technology and core competence of the company (Dunning, 1993). Patents, knowledge, the skills of the employees, and strategic supplies necessary for developing comparative advantages are examples of strategic resources. By focusing on developing strategic resources the company supports its long-term strategic objectives. Acquiring the assets of foreign corporations often does this. Accordingly, the main motive is therefore to either sustain or strengthen the competitive position, or weaken the competitors. In order for knowledge to have commercial value a company must prevent competitors from accessing such information (Oviatt and McDougall, 2005). Secrecy is often the best way of protecting knowledge that has commercial value. Knowledge based firms therefore protect themselves by the use of patents, copyrights, and so on. For companies, one way of gaining access to knowledge is to acquire other firms. Another way is to participate in some form of alliance in order to benefit from other companies knowledge base. We consider the latter of these two activities to reflect network seeking.

5. Network Seekers:

Dimitratos & Plakoyiannaki described networking as a dimension of international entrepreneurial culture. This network orientation within companies reflects to what extent companies participate in alliances, cooperative ventures and other forms of similar social connections. Networks, relations and collaborations with partners outside the organization can be very important for companies. By assessing the network seeking motives, companies intend to nurse, develop and expand their existing networks. Examples of network relations are personal connections, supplier-customer relations, contractual cooperation or other types of relations based on mutual gain and trust.

Chen and Ku mentioned how scholars have recently brought attention to relational capital and its importance. The relations between a firm and its customers, suppliers, partners, government agencies and research institutions can be included in the term relational capital that represents goodwill and trust. Investing in relational capital and local linkages enables the firm to create a competitive advantage. The relation can be beneficial for several parts of a network. A business network refers to a set of interdependent business relationships. One can argue that all firms are a part of a network. Relationships within a network can be short or long lived as well as being operated at arms length or up close and personal to facilitate knowledge sharing, innovation and value creation. An investor can decide to invest in local linkages depending on prior position and experience.

1.4 International Marketing Decisions

The firms engaged in international business have to make different types of decisions. Some of the important decisions are described below:

(i) International Business Decision:

The first decision a company has to make, of course, is whether to take up international business or not. This decision is based on serious consideration of a number of important factors, such as the present and future overseas opportunities, present and future domestic market opportunities the resources of the company, company objectives etc.

(ii) Market Selection Decision:

The next important step is the selection of the most appropriate market. For this purpose, a thorough analysis of the potentials of the various overseas markets and their respective marketing environments is essential. Company resources and objectives may not permit a company to do business in all the overseas markets. A proper selection of the overseas market(s), therefore, is very important.

(iii) Entry and Operating Decisions:

The next important task after the market selection decision is to determine the appropriate mode of entering the foreign market.

(iv) Marketing Mix Decisions:

The foreign market is characterized by a number of uncontrollable and controllable variables. The marketing mix consists of internal factors, which are controllable. The success of International marketing, therefore, depends to a large extent on the appropriateness of the marketing mix. The elements of the marketing mix should be suitably designed so that may be adapted to the characteristics of the overseas market.

(v) International Organization Decision:

A company desiring to do direct exporting has also to decide about its organizational structure, so that the exporting function may be properly performed. This decision should necessarily be based on a careful consideration of such factors as the expected volume of export business, the nature of overseas market, product, size and resources and length of its export experience.

1.5 Reasons for Growth of International Business

There are several reasons responsible for recent growth of International Business as described below:

1. Expansion of Technology:

In recent years, the pace of technological advances has accelerated at a phenomenal rate. The knowledge of products and services is available more widely and quickly due to great developments in communications and transportation technology. Today, we have Internet, commercial transatlantic supersonic travel, faxing, e-mailing, teleconferencing or overseas direct-dial telephone service and sales over the Internet, communication available almost instantaneously.

Technology has exercised tremendous impact on international business by increasing the demand for new products and services, thereby increasing the number of international business transactions. Greater distances are involved in conducting international business than conducting domestic business that increase operating costs and make control of a company's foreign operations more difficult. However, improved communications and transformation have sped up interactions and improved managers' ability to control foreign operations.

2. Liberalization of Cross-Border Movements:

International business also involves risk as the regulations may change at any time. Moreover, every country restricts the movement of goods and services and the resources across its borders. Such restrictions make international business more expensive to undertake. Today, governments are generally imposing fewer restrictions on cross-border movements of goods and services and the resources than they did 20 years ago. With the emergence of World Trade Organization, the restriction likely will continue to lower. Fewer restrictions enable companies to take better advantage of international opportunities. However, the increased competition requires people to work harder.

3. Development of Supporting Services:

The development of international business has facilitated the development of supporting services. For example, banks have developed efficient means for companies to receive payment for their foreign sales. Today, most producers can be paid relatively easily for the sale of their goods and services abroad. Banks credit agreements, clearing arrangements convert one country's currency into another's and insurance covers damage en route and non-payment by the buyer. The postal system has also dramatically developed today.

4. Increase in Global Competition:

The pressure of intense competition not only domestically but also foreign can persuade, a company to expand its business into international markets. Today companies can take advantage of many foreign business opportunities. They can spread their production and marketing operations to foreign markets and transport goods efficiently from most places.

Once a few companies respond to foreign market and production opportunities, other companies may perceive the foreign opportunities as well. Many other firms have to become more global to acquire and maintain competitiveness.

1.6 Summary

International business means marketing of goods and services across national frontiers. There is a difference between domestic marketing and international marketing but basically they are not much different. Firms go international in search of cheap raw material, cheap labour and higher profit. There are some special characteristics of international business. Wind, Douglas and perlmutter have identified four orientations towards internationalisation. Dunning introduced a model, for motives for Internationalisation. The firms engaged in international business have to make different types of marketing decisions.

1.7 Key Words

- **Ethnocentrism –** It is pre dominantly a home country orientation.
- **Polycentrism –** It is MNC orientation.
- **Regiocentrism –** It is regional orientation.
- **Geocentrism** – It is global orientation.
- **Cross Cultural** – Dealing simultaneously in various countries that are culturally different.

1.8 Self Assessment Test

1. Explain the rational for companies going for international business.
2. Discuss the four different types of international orientation.
3. Explain the meaning, significance and characteristics of international business.
4. Write a note on stages for Internationalisation
5. Give reasons for growth of international business.

1.9 References

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Unit - 2 : International Business Environment

Unit Structure:

2.0 Objectives

After studying this unit, you should be able to understand:

- The concept of the International Business Environment.
- The components of the International Business Environment.
- The significance of learning about the International Business Environment for a Manager.
- The main elements included in the Economic, Social Cultural, Demographic, Political, Legal, Regulatory, Natural and Technology Envirnoment in the arena of International Business.
- The impact of the International Business Environment on Business decisions.

2.1 Introduction

Companies can participate in the internatinal arena on a variety of levels. The process of globalization typically passes through four distinct stages:

1. Domestic: In the domestic stage, market potential is limited to the home country, with all production and marketing facilities located at home. Managers may be aware of the global environment and may want to consider foreign involvement.

2. International: In the international stage, exports increase, and the company usually adopts a multidomestic approach, meaning that competition is handled for each country independently. Product design, marketing, and advertising is adapted to the specific needs of each country, requiring a high level of sensitivity to local values and interests.

3. **Multinational (MNC):** In the multinational stage, the company has marketing and production facilities located in many counties, with more than one-third of its sales outside the home country. These companies adopt a globalization approach, meaning they focus on delivering a similar product to multiple countries. Product design, marketing, and advertising strategies are standardized throughout the world.

3. Global: Finally, the global (or stateless) stage of corporate international development goes beyond any signle home country. These corporations operate in true global fashion, making sales and acquiring resources in whatever country that offers the best opportunities and lowest cost.

These four stages have been presented in a table given below:

Table 2.1
FOUR STAGES OF GLOBALIZATION

	1.DOMESTIC	2.INTERNATIONAL	3. MULTINATIONAL	4.GLOBAL
Strategic Orientation	Domestic Orientation	Export –Oriented, Multi-Domestic	Multi-National	Global
Stages Of Development	Initial Foreign Involvement	Competitive Positioning	Several International Operations	Global
Cultural Sensitivity	Unimportant	Very Important	Important	Critically Important
Manager Assumptions	'One Best Way'	'Many Good Ways'	'The Least Cost Way'	'Many Good Ways'

On the basis of the various stages in which they are operating a firm in international business encounters four different sets of environment :

- Internal environment
- Domestic environment
- Foreign environment
- Global environemnt

(i) The domestic environment refers to the home country environment which include the government policies and regulations governing foreign business of domestic companies.

(ii) The foreign environment refers to the environment of the relevant foreign market.

(iii) The global environment refers to those global factors which are relevant for business, such as the W.T.O. principles, international treaties, agreements etc.

(iv) The internal environment of the firm is also important. The competence of a firm to do international business depends of a number of internal factors like the mission and vision of the firm, the attitude, capabilities and commitment of the top management and the employees of the organisation, organisational structure and decision taking and implementing factors, financial and other resources and capabilities. Intenrational business requires adherence to production and delivery schedules, commitment to quality, quick and effective response to customer requirements, cost competitiveness, innovativeness, etc..

ENVIRONMENT OF INTERNATIONAL BUSINESS

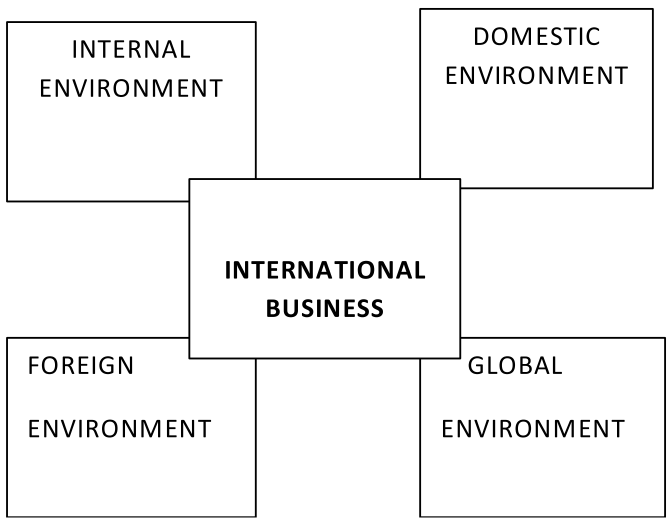

Figure : 2.1

2.2 Elements of International Business Environment

International management is the management of business operations conducted in more than one country. The fundamental tasks of business management, including the financing, production, and distribution of products and services, do not change in any substantive way when a firm is transacting business across international borders. The basic management functions of planning, organizing, leading, and controlling are the same, whether a company operates domestically or internationally. However, managers will experience greater difficulties and risks when performing these management functions on an international scale and while trying to operate in a competitive global environment. Companies seeking to expand their international presence on the Internet can also run into cross-cultural problems.

What should managers of emerging global comapnies look for to avoid obvious mistakes ? When they are comparing one country with another, the economic, legal-political, and sociocultural sectors present the greatest difficulties. Managers must thus understand the main factors in the international environment and assess the impact that these factors may have on their international business decisions. The Main Elements of the International Environment have been presented in figure 2.2

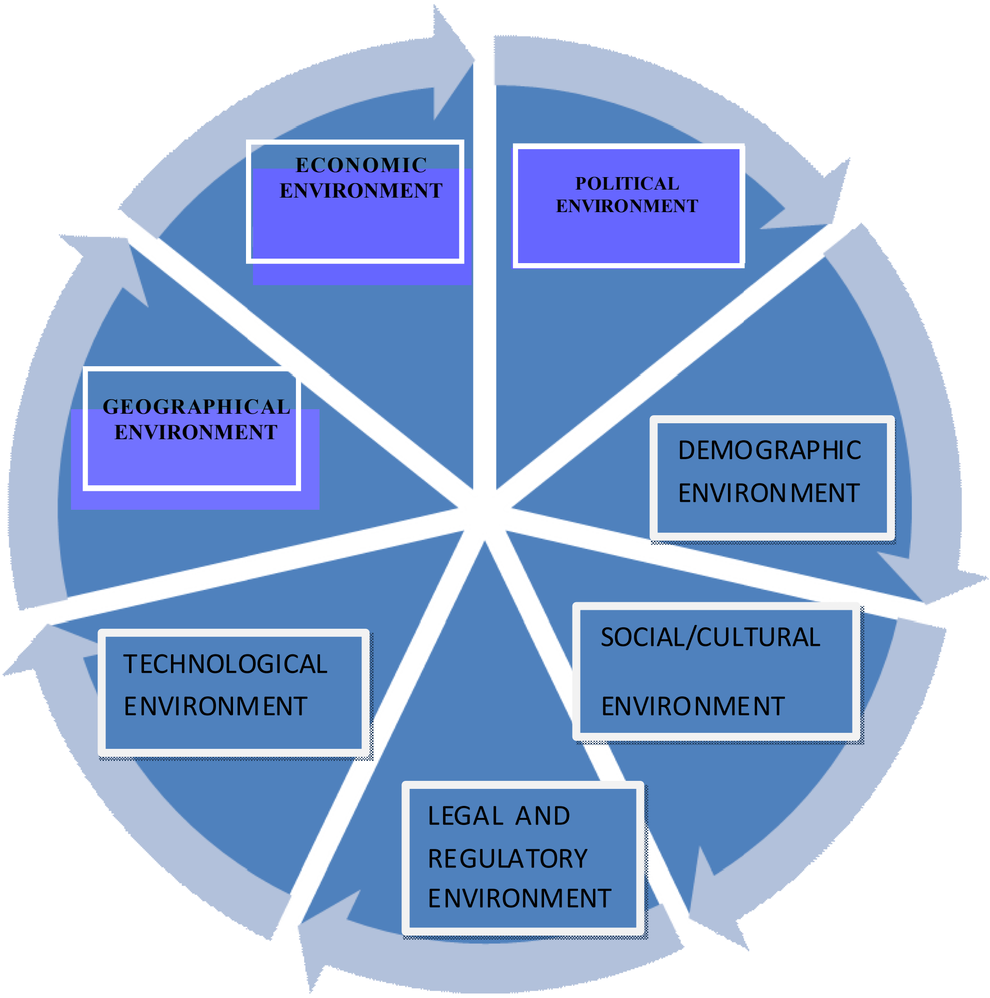

Figure 2.2

Why Companies Engage in International Business?

When operating internationally, a company should consider its mission (what it will seek to do and become over the long term), its objectives (specific performance targets to fulfil its mission), and strategy (the means to fulfil its objectives). Three major operating objectives may induce companies to engage in international business. They are :

- To expand sales by entering new markets.
- To acquire resources of better quality or at more competitive prices.
- To minimize risk by operating in a larger region or a different country.

What influences international business operations?

Carrying out of the international business operations depends upon both the internal and external influences. The Internal Influences include :

- The objectives of the company.
- The means of carrying out the business to meet objectives which includes mode, functions and the various alternatives. The operations are also deeply influenced by the external environment as well the external influences includes all the factors, geographical, influences, socio-cultural, factors, political factors, legal and regulatory factors and technological factors.

The figure shows how both the objectives and means of meeting these objectives on one hand and the influence of the factors involved in the external environment have a far reaching impact upon why business is carried out by an organization in the international arena. Thus, it is very important for an organization to study its external environment very carefully, if it is to create a successful strategy for its international operations.

Influences upon the Operations and Strategy of International Business

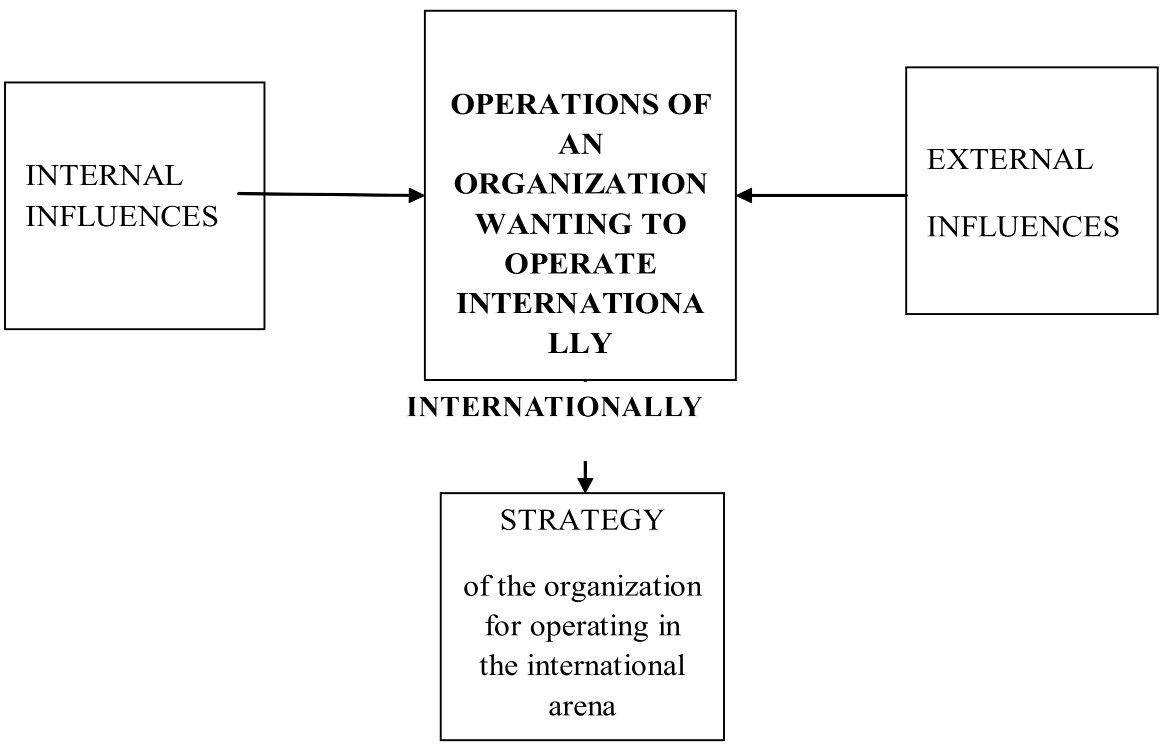

Figure 2.3

Significance of International Business Environment

We have already discussed how the development of international business strategies makes analysing the international business environment very important. International business strategy is different from the domestic strategy because of the differences in the business environment. In fact, significant differences in the business environment may exist even within the country, particularly if the country is as diverse as India. However, the differences in business environment between nations are often more substantial than within a country. This makes it crucial to make a detailed analysis of the business environment of the foreign countries for formulating effective and successful international business strategies. We will now examine each of the elements of the environment relevant for international business one by one.

2.3 The Economic Environment

The economic environment represents the economic conditions in the country where the international organization operates. This part of the environment includes factors such as economic development, infrastructure, resource and product markets, and exchange rates etc. Factors such as inflation, interest rates, and economic growth are also part of the international economic environment. Let us examine some of the important aspects of the economic environment that may influence the international business operations of an organization.

(i) Level of Economic Development:

Economic development differs widely among the countries and regions of the world. Countries can be categorized as either developing or developed. Developing countries are sometimes referred to as less-developed countries (LDCs). The criterion traditionally used to classify countries as developed or developing is per capita income, which is the income generated by the nation's production of goods and services divided by total population. The developing countries have low per capita incomes. LDCs generally are located in Asia, Africa, and South America. Developed countries are generally located in North America, Europe, and Japan. Most international business firms are headquartered in the wealthier, economically advanced countries. However, smart companies are investing heavily in Asia, Eastern Europe, and Latin America. These companies face risks and challeges today, but they stand to reap huge benefits in the future.

(ii) Per Capita Income:

On the basis of the per capita income (i.e., the average annual income per person) countries are identified as low income, middle income and high income economies. Low income economies are economies with very low level of per capita income. All economies with per capita GNP of $ 745 or less in 2001 are regarded as low income economies. High income economies are countries with very rich income per capita. Those with a per capita GNP of $ 9206 or above in 2001 fall in the category of high income economies. There are mainly two categories of high income economies namely, industrial economies and oil exporters.

Falling in between the low income economies and high income economies are the middle income economies.

The middle income economies are those with per capita income between $ 746 and $ 9205 in 2001. The low income economies are sometimes refered to as the third world. The high income and middle income economies representing the first and second worlds.

Yet differences in the income levels between countries is not a true reflection of the purchasing powers or living standards of people. For example, international comparisons of GNP and per capita income in a nominal currency unit (say US $) do not reflect a realistic picture because the purchasing power of the national currencies vary. Further, exchange rate changes would give a misleading picture of the economic position of the country when the income is converted into dollars from the national currency. For instance, if the national currency has depreciated against the dollar at a rate higher than the GNP growth rate, when the GNP is converted into dollar, it will show a decline even though the GNP has actually increased in terms of the national currency. To overcome such problems, it has become common to estimate the GNP and per capita income at purchasing power parity (PPP). For example, in 2001 the per capita income of India was estimated at $ 460; in PPP terms it was estimated at $ 2450. What it means is that a bundle of goods which costs $ 460 in India will cost $ 2450 in USA. In other words, having $ 460 in India is equivalent to having $ 2450 in USA.

(iii) Infrastructure:

A country's physical facilities that support economic activities consist of its infrastructure, which includes transportation facilities such as airports, highways, and railroads; energy-producing facilities such as power plants; and communication facilities such as telephone lines and radio stations. Companies operating in LDCs must contend with lower levels of technology and complex logistical, distribution, and communication problems. Undeveloped infrastructures may represent opportunities for some firms, such as United Technologies Corporation, based in Hartford, Connecticut, whose businesses include jet engines, air conditioning and heating systems, and elevators. As countries such as India and Russia open their markets, new buildings need elevators and air and heat systems; also opening remote regions for commerce requires more jet engines and helicopters. Similarly cellular telephone companies have found a lot of opportunities in LDCs. In India the number of mobile phones is huge and this happened after telecommunications was privatized and foreign operators were allowed to enter the market in the mid-1990's.

(iv) Resource and Product Markets:

When operating in another country, company managers must evaluate the market demand for their products. If market demand is high, managers may choose to export products to that country. To set up manufacturing plants, resource markets for providing needed raw materials and labour must also be examined. For example, the greatest challenge for McDonald's, which sells Big Macs on every continent except Antarctica, is to obtain supplies of everything from potatoes to hamburger buns to plastic straws. McDonald's tries to contract with local suppliers when possible. Sometimes McDonald's helps farmers to cultivate Potatoes of sufficient quality to produce their golden french fries.

(v) Exchange Rates:

Exchange rate is the rate at which one country's currency is exchanged for another country's. Volatillity in exchange rates has become a major concern for companies doing business internationally. Changes in the exchange rate can have major implications for the profitability of international operations that exchange millions of dollars into other currencies every day. Take the example of the increase in dollar price versus the Indian rupee. Goods purchased in US Dollars will become more expensive for Indian traders because it will take more rupees to buy a dollar's worth of goods. Thus there will be an immediate impact on an importer based in India.

(vi) Structure of the Economy:

The structure of the economy - factors such as contribution of different sectors like primary (mostly agricultural), secondary (industrial) and tertiary (secondary) sectors; large, medium, small and tiny sectors to the economy, and their linkages; integration with the world economy, etc. are important to business. These factors indicate the prospects for different types of business they affect the business.

Normally, as an economy develops the share of the primary sector in the GDP and employment declines and those of the other sectors increase. After a certain stage the share of the manufacturing sector may also decline. In most of the countries the service sector is the largest and fastest growing sector. The services sector now contriubtes more than 60 per cent of the world GDP.

The developed economies are primarily service economies in the sense that the service sector generates a bulk of the employment and income. The contribution of services to GDP and employment is substantially high, particularly, in the developed economies. Although the share of services in the GDP of developing economies is lower than in the developed ones, the service sector has been growing very fast in the developing world. The growing importance of services is reflected in international trade too. The growth rate of trade in services have been faster than that of goods.

The nature of each sector also has implications for business. Although India is one of the largest producer of several agricultural products, because of the small and fragmented nature of the land holdings, efficient collection and processing of the produce are difficult. The land holding pattern also makes productivity improvements difficult. This has implications for the agricultural inputs business. For example smaller sturdier tractors will be more in demand in India than larger tractors which are more appropriate for larger land holdings.

(vii) Economic Policies:

there are several economic policies which can have a very great impact on business. Important economic policies are industrial policy, trade policy, foreign exchange policy, monetary policy, fiscal policy and foreign investment and technology policy. Some categories of business are favourably affected by government policy, some are adversely affected. For example an industry that falls within the priority sector in terms of the government policy may get a number of incentives and other positive support from the government, whereas those industries which are regarded as inessential may have the odds against them.

(a) Industrial Policy : Industrial policy can define the scope and role of different sectors like private, public, joint and cooperative, or large, medium, small and tiny. It may influence the location of industrial undertakings, choice of technology, scale of operation, product mix and so on.

In India, until the liberalisation ushered in 1991, the scope of foreign investment and technology was very limited. However, the new policy ushered in July 1991 has opened up many industries for foreign investment, changing the business environment to a large extent. Liberalisation has enormously expanded business opportunities. It has also increased competition tending to make survival of the fittest the order. While many companies entered new businesses, many exited from some of their old businesses, unable to be competitive in the new environment.

(b) Trade Policy : The trade policy can have a significant impact. For example, a restrictive import policy, or a policy of protecting the home industries, may greatly help the home industries, while a liberalisation of the import policy may create difficulties for such industries.

Liberalisation of imports facilitate global sourcing and this could help many Indian firms to become more competitive.

(c) Foreign exchange policy : Exchange rate policy and the policy in respect of cross-border movement of capital are important for business. The abolition/liberalisation of exchange controls all around the world since the late 1970s have encouraged cross-border movement of capital.

(d) Foreign investment and technology policy : Until the late 1980s, when the world wide trend towards Restrictions of foreign capital and technology constrain not only the foreign firms but also the domestic firms because it may come in their way of acquiring the technology of their choice from the best source. Restrictions of foreign capital may affect the growth plans of firms, including establishment of joint ventures. We can see how huge investments in infrastructural and other vital sectors significantly improved the environment for industrial development in China.

(e) Fiscal policy : Government's strategy in respect of public and revenue can also have effect the business. Governments often use tax incentives or disincentives to encourage or discurage certain activities. For example, when an industry suffers from recession, a reduction of taxes like excise duty or sales tax may help improve the demand.

(f) Monetary Policy : The central bank, by its policy towards the cost and availability of credit, can significantly influence the savings, investments and consumer spending in the economy. Depending on the conditions of the economy and the general economic policy of the government, the central bank (Reserve Bank of India) may adopt an expansionary or contractionary or neutral monetary policy. For example, even a slight reduction in the Cash Reserve Ratio (CRR) or Statutory Liquidity Ratio (SLR) will significantly increase the loanable funds with the commercial banking system. Monetary policy may also be used to influence the exchange rate of the currency.

(viii) Economic Conditions:

Economies pass through periods of boom and recession. A boom is characterised by high level of output, employment and rising demand and prices. A recession is the opposite. If a region depends to a significant extent on any particular industry or sector, business in that region would be significantly affected by the fortunes of that industry. The economic and business prospects in major oil exporting countries depend to a very great extent on the crude oil price.

The current account and balance of payments positions of a country can also significantly influence certain economic policies and business environment. For example, a sustained current account surplus may encourage the government to liberalise imports and capital movements. Exports and imports of a country are affected by a number of domestic and international economic conditions.

International economic conditions could be :-

- The rate of growth of the economies of the importing countries.
- The rate of growth of world trade.
- The rate of change in the price level in the importing country.

The Domestic economic conditions include :-

- The rate of growth of the domestic economy.
- The rate of change in the domestic price level.

2.4 The Socio-Cultural Environment

A nation's culture includes the shared knowledge, beliefs, and values, as well as the common modes of behavior and ways of thinking, among members of a society. Social and Cultural factors can be even more perplexing than political and economic factors when working or living in a foreign country.

Knowledge and beliefs : The knowledge and beliefs refer to a people's prevailing notions of reality. They include myths and metaphysical beliefs as well as scientific realities.

Ideals : Ideals refer to the societal norms which define what is expected, customary, right or proper in a given situation.

Preferences : Preferences refer to society's definitions of those things in life which are attractive or unattractive as objects of desire. Preferences may differ between cultures.

Let us see how social/cultural aspects can impact international business :

(i) Social Values :

Culture is intangible, pervasive, and difficult for outsiders to learn. One way managers can comprehend local cultures and deal with them effectively is to understand differences in social values. The Hofstede - Hermes study has shown how different countries have a different emphasis on social values. Let us study the research of the Hofestede - Hermes framework to understand the concept of national value systems better.

Hofestede's Value Dimensions:

Research done by Geert Hofstede on 116,000 IBM employees in 40 countries identified four dimensions of national value systems that influence organizational and employee working relationship. Examples of how countries rate on the four dimensions are shown in the table that follows.

1) **Power distance**: High power distance means that people accept inequality in power among institutions, organizations, and people. Low power distance means that people expect equality in power.

2) **Uncertainty avoidance :** High uncertainty avoidance means that members of a society feel uncomfortable with uncertainty and ambiguity and thus support beliefs that promise certainty and conformity. Low uncertainty avoidance means that people have high tolerance for the unstructured, the unclear, and the unpredictable.

3) **Individualism and collectivism :** Individualism reflects a value for a loosely knit social framework in which individuals are expected to take care or themselves. Collectivism means a preference for a tightly knit social framework in which individuals look after one another and organizations protect their members' interests. Countries with individualist values include the United States, Candada, Great Britain, and Australia. Counties with collectivist values are Guatemala, Ecuador, and China.

4) **Masculinity/femininity :** Masculinity stands for preference for achievement, heroism, assertiveness, work centrality (with resultant high stress), and material success. Feminity reflects the values of relationships, cooperation, group decision making, and quality of life. Societies with strong masculine values are Japan, Mexico, and Germany. Coutnries with feminine values are Sweden, Denmark, and France. Both men and women subscribe to the dominant value in masculine and feminine cultures.

Hofstede and his colleagues later identified a fifth dimension, long-term orientation versus short-term orientation. The long-term orientation, found in China and other Asian countries, includes a greater concern for the future and highly values thrift and perseverance. A short-term orientation, found in Russia and West Africa, is more concerned with the past and the present and places a high value on tradition and meeting social obligations.

Table : 2.2

Rank Orderings of Ten Countries along with Four Dimensions of National Value Systems

Country	Power Distance	Uncertainty Avoidance	Individualism	Masculinity
Australia	7	7	2	5
Costa Rica	8 (tie)	2 (tie)	10	9
France	3	2(tie)	4	7
West Germany	8 (tie)	5	5	3
India	2	9	6	6
Japan	5	1	7	1
Mexico	1	4	8	2
Sweden	10	10	3	10
Thailand	4	6	9	8
United States	6	8	1	4

1 = Highest Rank
10 = Lowest Rank

(ii) Cultural Adaptation:

The term cultural adaptation refers to the manner in which a social system or an individual fits into the physical or social environment. The social system may be a small group, such as the family or a larger collectivity, such as an organisation, or even a total society, like a tribal society. More flexible cultures adjust to new environments better.

(iii) Cultural Shock:

Environmental changes sometimes produce cultural shock - a feeling of confusion, insecurity, and anxiety caused by the strangeness of the new environment. Executives and other employees on foreign assignments may experience cultural shock in alien environment. Some times the organisation itself may suffer shock. Proper home work to understand the culture can help avoid the shock. This also indicates the importance of the selection of people for foreign markets, who are less likely to react to new cultures with shock.

(iv) Cultural Transmission:

The elements of culture are transmitted among the members of the culture, from one generation to the next, and to the new members admitted into the culture. Some of the aspects of a culture may be transmitted to other cultures also. The transmissive quality of culture makes it cumulative. Every generation inherits a stock of cultural elements, many of which have been accumulated over a long period of time. As time goes on, cultures accumulate more techniques, ideas, products and skills. Certain old elements may be dropped as new ideas and traits are acquired. Cultural accumulation, facilitated by cultural transmission, enables man to build upon the achievements of the past.

(v) Cultural Conformity:

Individuals in a culture tend either to conform to the cultural norms or to deviate from them. 'Strong Cultures' are those where the people have a passionate belief for its values and norms. Individuals are more likely to conform in such strong cultures.

(vi) Cultural Lag:

Various parts of modern culture do not change at the same rate. Since there is a correlation and interdependence of parts, a rapid change in one part of our culture requires radjustments through other changes in various correlated parts of that culture. These readjustments are difficult, because of a variety of factors, ranging from ignorance to active resistance. Technological changes call for adaptive changes in non-material culture, which is basically conservative.

(vii) Religious Beliefs:

Different people have different religious convictions, beliefs, sentiments, customs, rituals, festivals, etc. The price of ignoring religious aspects could be fatal, in international business. McDonald invented the McChicken Burger primarily to serve the Indian Market and even come out with a 'Navratra Week' to stay attuned to Indian sentiments. Religion may also influence the attitude towards work and wealth. Religion may also play a role in deciding the weekly holiday, other holidays and working hours. In several countries religious festivals are great business times. In Middle Eastern countries Friday - the Islamic day for speical prayers and Saturday are the two days off in a five working day week. Christmas is the booming business period in western countries whereas in India it would be around Diwali time.

(viii) Ethnodomination :

In many countries, industry or trade is dominated by certain ethnic groups. This is particularly true of trade. Ethnodominatioin in distribution is a situation where an ethnic group occupies a majority position in a channel of distribution with respect to the ownership and control of physical and financial resources, or through the manipulation of social environment.

There are a number of cases of ethnodomination in India e.g. There is dominance of a certain community in banking and money lending like the Chettiars in Tamil Nadu and Vysyas in Karnataka, in South India. Regional patterns of enterpreneurship, which also have some ethnic aspects like Udupi Restaurants and Punjabi Dhabbas have gone international. Several exporters target ethnic population abroad by exporting Indian curry powders, pickles and papad.

(ix) Etiquettes:

Meeting and greeting people, expressing appreciation or disapproval, showing respect, conducing meetings and functions, table manners, etc. vary widely between cultures. What is regarded as the right behaviour in one culture may be offensive behaviour in some others.

There are differences in the manners of greeting people and physical distance to be kept between people. While embracing, hugging or kissing is common in some cultures, they are quite embarrassing, and even highly objectionable in many societies.

Even laughter is interpreted differently around the world. While most countries consider it an expression of joy, some cultures discourage it. In many west African countries, laughter indicates embarrassment, discomfort, or surprise. A smile of an unffamiliar person will not generate a smile in return every where; some times it may even cause suspicion.

(x) Language Variables:

Differences in the language is an important problem area in business. Take the example of the Arabic language is read from right to left and many Arabians sequence things from right to left. A multinational blundered in the Middle East when in the advertisement of its detergent it pictured soiled clothes on the left, the box of detergent in the middle and clean cloths on the right. The advertizement showed that the detergent would soil the clean clothes when read in the context of right to left of Arabic.

Non verbal communications create equally, perhaps even more, difficult problems. Body language has different interpretations in different cultures. The same symbols and gestures, may mean different things in different countries and some times in different regions of the same country. A symbol or gesture that represents an appreciation in one society may mean a different thing in another. For example, the thumbs up sign, with the thumb held straight up and four fingers kept folded represents approval in countries like USA, UK and Russia; it is highly offensive in Iran and regarded as rude in Australia.

2.5 Demographic Environment

Demographic factors such as size of the population, population growth rates, age composition, ethnic composition, density of population, rural-urban distribution, family size, nature of the family, income levels, etc. have significant implications for business. A company operating in or entering a new country must analyse its demographic environment.

(i) Population Size:

The size the population is an important determinant of demand for many products. There are countries with less than a lakh of people on the one hand and those with thousands of millions on the other hand. Obviously countries with a large population and higher per capita income will be more attractive markets for international business.

(ii) Falling Birth Rate in Developed Countries:

Declining birth rates in the developed world as well as better health and medical facilities and a subsequent rise in longevity of people is leading to a steep decline of population in the developed world.Less people implies a decline in demand for products and services.

(iii) Population Explosion in Developing Countries:

The developing countries on the other hand are witnessing a population explosion and which there are serveral problems associated with this, it also offers greater opportunities to market products.

(iv) Changing Age Structure:

The failling birth rate and rising longevity will significantly alter the age distribution within the population. The proportion of the aged people in the total population will go up.

The changes in the age distribution have a lot of implications for business. Several pharmaceutical companies, for instance, are paying a lot attention to the potential requirements of the aged population. Life Insurance Policies are also structured keeping and mind the profile of the population of the country in which the life insurance company intends to do business.

(v) Migration and Ethnic Aspects:

While the population is declining in many developed countries, leading to labour shortage, population presssure is mounting in developing nations, many of which are neighbours of the rich nations. This leads to migration of the population and related issues. The response to immigration differs between countries. Immigration is and shall continue to be a hot political issue in a number of countries.

2.6 Political Environment

Businesses must deal with unfamiliar political systems when they go international, as well as with more government supervision and regulation. Government officials and the general public often view foreign companies as outsiders or even intruders and are suspicious of their impact on economic independence and political sovereignty. Some of the major political concerns affecting international business are political risk and political instability :

(i) Politcal risk refers to a company's risk of loss of assets, earning power, or managerial control due to politically based events or actions by host governments.

(ii) Political instability refers to events such as riots, revolutions, or government upheavals that affect the operations of an international company.

The political environment includs the characteristics and policies of the political parties, the nature of the Constitution and government system and the environment. These factors vary considerably between different nations. The political environment and the economic policy environment are deeply linked. Major economic policy changes often have political motivations. Important economic policies are often political decisions. They include :

- Industrial policy
- Policy towards foreign capital and technology.
- Fiscal policy
- Export-import policy

Many political decisions have serious economic and business implications. For example, prohibition (of alcohol) is a political decision; but it affects the alcohol and related industries. To make the revenue loss due to prohibition, government may increase taxes. Thus, the economic policy of the ruling party of the country is very important and must be understood by any body wanting to do business in that country.

Other factors in the Political Environment include :

- **Form of Government :** If the government has primarily a capitalist leaning or has a great impact upon the way business is conducted and have intrernational business organizations are allowed to operate.

- **Foreign Policy :** The foreign policy of the government of a country will determine its diplomatic status and trade links and directly impinge upon the business scenario.

- **State Undertakings :** The extent to which Public sector undertakings exist and operate in an economy will also impact the competition that international business may face. Sometimes a planned economy may reserve certain sectors for public sector undertakings restricting entry of international players.

- **Role of Military :** Certain countries may have military dictatorships and business and trade in such economies would largely depend upon the ideas and policies of the people in power.

- **Level of Terrorism :** Countries where terrorism has created difficulties in carrying out business and sometimes normal life are deterants for international business which would not risk foraying into such a country.

¨ Political tensions with other countries : When a country has strained relations with another country it has a direct impact upon the level and variety of trade between the two countries. Sometimes world organizations like UNO may level sanctions against a country and all the member countries would adhere to these sanctions. For example UNO had declared trade sanctions against South Africa during the time it practiced 'Apartheid'.

2.7 Legal and Regulatory Environment

Different countries have different policies and regulations with regard to the conduct of the business. In fact certain trade practices or promotional methods that are allowed in some counties may be considered as unfair by the laws of some other countries. In many countries there is a lot of restriction on the use of the media. Radio and Television, are under State monopoly or under strict state control in a number of countries.

(i) Kinds of Legal Systems:

The legal systems that exist in different countries across the world may be classified into three categories: Common law, civil law or code law, and theocratic law.

- The basis for common law is tradition, past practices, and legal precedents set by the courts through interpretations of statutes, legal legislation, and past rulings. Common law seeks "interpretation through the past decisions of higher courts which interpret the same statutes or apply established and customary principles of law to a similar set of facts.
- Civil law, on the other hand, is based on an all-inclusive system of written rules (codes) of law. Under civil law, the legal system is generally divided into three separate codes : commercial, civil, and criminal. Rules for conducting business transactions are a part of the commercial code. When entering into contracts abroad, it is important for the manager to understand which type of legal system will establish the contract.
- The theocratic law system is based on religious precepts. The best example of this system is Islamic law, which is found in Muslim countries. Islamic law, or Shair'a, is based on the following sources: The Koran, the sacred text; the Sunnah, or decisions and sayings of the Prophet Muhammad; the writings of Islamic scholars, who derive rules by analogy from the principles established in the Koran and the Sunnah; and, the consensus of Muslim countries' legal communities.

(ii) Laws relevant to International Business:

There are three sets of laws and regulations relevant to international business :

- **Laws and regulation in the Home Country.**

  International Laws, treaties, conventions etc. : International business is governed or influenced by several laws, treaties, agreements, conventions, etc.

- **Laws of Foreign Countries :**

  A firm doing business abroad has to consider the relevant laws and regulations of the concerned foreign countries. The national laws governing business may be different in different countries. Laws related to product packaging and labelling, price, promotion, and trade practices, are among the important regulations which exporters should consider.

(a) **Product Standards :** Many countries have established standards for many of the products. Such standards pertain to quality, safety, helath consideration, etc. For example, ISO 9000 accredition is necessary for certain products for selling in markets like the European Union. Each Country may have its own product standards or specifications. Take the example of the automobile industry which must keep in mind whether it is selling the car in a left drive or a right drive country.

(b) **Disclosures :** In case of several products like pharmaceuticals in many countries it is mandatory to make certain disclosures about the products like the ingredients, potency, shelf life, possible side effects etc.

(c) **Environmental Laws :** Regulations related to environmental protection are on the increase. If the production or harvesting of the products cause serious ecological problem it may not be permitted to be marketed in some countries. Similarly, biologically non-degradable packaging may not be allowed or penalties or fees may have to be paid for the social costs of using such materials.

(d) **Product Liability :** If a person suffers any damage because of a product, the consumer laws of the country will dictate as to how responsibility will be fixed and compensation granted.

(e) **Packing and Labelling Regulations :** Countries have their own regulations regarding packaging and labelling. There may be regulations regarding the packaging materials to be used methods of packaging and packaging standards.

(f) **Regulation of Price :** Many countries have laws regulating price. For example the price of petrol is regulated in India.

(g) **Regulation of Promotion :** Promotional activities are, generally, subject to various types of controls. In fact advertising and product promotion is subject to various types of controls. For examples - Countries have organizations to control advertisign standards which regulate the content and message of advertisements.

(h) **Regulation of Trade Practices :** Many countries have laws regulating trade practices like restrictive trade practices, and laws designed for consumer protection etc.

Example:

There are some important legislations in India regarding exports. The most important law regulating the foreign trade of India is the Foreign Trade (Development and Regulation) Act, 1992, which has replaced the Imports and Exports (Control) Act, 1947.

The objective of the Foreign Trade (Development and Regulation) Act, 1992, is to provide for the development and regulation of foreign trade by facilitating imports into, and augmenting imports from India and matters connected therewith or incidental thereto. The Act empowers the Central Government to :

(i) Make provisions for the development and regulation of foreign trade by facilitating imports and increasing exports; and

(ii) Make provisions for prohibiting, restricting or otherwise regulating the imports and exports of goods.

2.8 Geographical Environment

Ecology and technology are inter-dependent; technology is always built upon what is physically possible in the natural environment, and the natural environment can be degraded or enhanced, made more productive for human uses or depleted for any use, by the application of technology. This indicates the potential for development of business in a region by the use of technology. The extent to which this potential is exploited eventually depends upon the economic, social and demographic, and political environments.

The natural environment provides the raw materials, energy sources, life-sustaining factors and even waste disposal sites. The natural environment determines what can be done in a society and how institutions can function. Resource availability is the fundamental factor in the development of business in societies.

The pattern of international trade is determined by the factor endowments of different countries. The natural factors vary very widely between nations. Indeed the geographical pattern of distribution of resources is an important source of international business. This can be seen in the state of the economy of OPEC (oil Producing and Exporting Countries) nations or the economies of ports like Singapore and Hongkong which are trading hubs.

Thus, geographical and ecological factors, such as natural resource endowments, weather and climatic conditions, topographical factors, locational aspects in the global context, port facilities, etc. all contribute towards deciding the level or nature of business in the international arena.

2.9 Technological Environment

Technological developments have greatly changed the business scene. They facilitate not only the introduction of new products but also tremendous improvements in the operational efficiency and bring about changes in the way business is done. It implies that even when there is demand for an old product, adoption of modern technology for the conduct of the business would be necessary for survival.

Information technology has not only transformed marketing and the financial markets scenario but has also significantly contributed to the globalisation process. The type of technology in use, the level of technological developments, the speed with which new technologies are adopted and diffused, the type of technologies that are appropriate, the technology policy, etc. are important factors which international business must analyze.

Technology is one of the eight factors considered by the World Economic Forum to evaluate the global competitiveness of nations. The 1999 Global Competitiveness Report of the Forum, observes that there are three aspects of information technology as a source of competitiveness. Firstly, e-mail has greatly expanded the possibilities for interprersonal, inter-firm, and international communication. Secondly, the Internet has allowed for much more extensive and rapid dissemination of information. Thirdly, the emerging area of e-commerce offers a potentially huge increase in the customer base for companies and huge savings in marketing costs and search costs in finding low-cost suppliers. Competitiveness in all of these areas is closely linked with the competitiveness of the telecommunication infrastructure. With the penetration of the computer culture, the population needs to have computers, telephones need to work, and the country's telecommunications hardware needs to support high bandwidth for Internet traffic.

2.10 Summary

International Business Environment is an important area of study for successfully operating in an International Level. Successful business ventures may enter the international arena to expand sales by entering new markets, acquire resources of better quality or at competitive prices or to minimize their risk by expanding the regions in which they operate. If international business managers are keen to run successful business they must carefully study and analyze the international business environment. The international business environment consists of :-

(i) The Economic Environment - This refers to the Level of Economic Development, the per capita income, infrastructure available, Resources and Product markets structure of the economy, economic policies, and economic conditions of the region/country one operates or intends to operate in.

(ii) The Social/Cultural Environment : This involves studying the social values, cultural adaptation, cultural shock, culture transmission, culture conformity, culture lab, religious, beliefs, ethnodomination, etiquettes and language variables of a region/country.

(iii) The Demographic Environment : This refers to the population size, birth rates, age structure, migration and ethnic aspects of regions or countries.

(iv) The Political Environment : This refers to the study of political risk and political instability along with a host of factors like the type of government, its policy towards public sector etc.

(v) Legal and Regulatory Environment : This involves understanding the laws and regulations of the region or country one wants to do business with and also involves understanding international laws.

(vi) The Geographical Environment : This refers to the geographical terrain and natural resources of the country or region one wants to or is operating in.

(vii) The Technological Environment : This refers to the level and reach of technology available for conducting business and the feasibility of its use in one's business.

2.11 Key Words

- **International Business Environment :** It is the environment that is relevant for an organization operating on the inernational level and includes a number factors like the economic environment, the social / cultural environment, the demographic environment, the political environment, the legal and regulatory environment, the geographical environment and the technological environment. Each of these factors may have an impact upon how successfully the organization operates in the international business arena.
- **Demographic –** It is relates to population characterristic.
- **Per capita income –** Total income of a country divided by its population.
- **Exchange Rate –** The rate rate at which currencies are exchanged.
- **Monetary Policy –** Monetary policy relates to the government policy of control of credit by its central Bank (in India RBI)
- **Fiscal Policy –** Government policy of taxation and expenditure.
- **Masculinity –** Stands for heroism, assertiveness
- **Femininity –** Stands for virtue of relationship cooperation, group decision making and quality of life.

2.12 Self Assessment Test

1. What is the International Business Environment ? What does it consist of ?
2. What is the significance of studying the International Business Environment for a manager of a business that wants to expand internationally ?
3. What are the aspects of the economic environment that an international business manager must consider about the country in which his organization operates ?
4. 'Social and Cultural factors may be more perplexing than economic, factors for international managers'. Discuss this statement giving examples.

5. Can the politcal scenario have a far reaching impact upon an international business ? How ? Illustrate your answer with real life examples.

6. What are the various types of laws and regulations that a manager operating internationally must analyze and understand ?

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Unit - 3 : Modes of Entering International Markets

Unit Structure:

3.0 Objectives

After studying this unit, you will understand:

- The main reasons that encourage organizations want to operate in the international business environment,
- The forces that drive or restrain companies from going global.
- The various modes of entering international markets and what are the advantages and disadvantages of each, and
- The main operating strategies of a Global Organization to compete in and manage its global operations most efficiently.

3.1 Introduction

Our everyday lives are increasingly being influenced by businesses from around the world. We have become part of a global village and in the global economy, no organization can stay unaffected by the effects of foreign markets and competition.

- ♦ Even Businesses that aren't directly marketing their products and services internationally, are involved in international business, because they are competing with foreign companies.
- ♦ More and more firms are reshaping themselves for foreign competition and exploring new ways of entering global markets.

Why does a business wishes to go international ? The reason is simple : Many international markets provide opportunites and returns for those businesses who have the ability and determination to succeed in an unfamiliar environment. Companies may venture abroad because of declining markets at home and brighter opportunities overseas. Some business venture abroad tend to use excess manufacturing capacity. Others establish manufacturing facilities world wide, to achieve economies of scale, which provide them with a significant cost advantage over competitors. Other companies go international to reduce the risk of operating in only one geographical market.

Whatever the motive, businesses internationalize to get returns that are not so readily available at home. However, venturing into an international market is an exceptionally challenging strategy. Once a company decides to do business abroad it confronts an entirely new set of circumstances. In many countries, a business will find that consumer preferences are different. Marketing (i.e., pricing, promotional strategies, advertising, and distribution systems) is unique as are financial markets and accounting systems. The motivations and perspectives of host country employees may also differ along with personnel policies that are needed for doing business. The country's political environment and the relationship between business and government may be distinctly different. A gap may exist between the culture at home and the culture in the international market. Thus, doing business abroad often requires setting aside many assumptions of doing business and building a new set of assumptions for an unfamiliar environment. International businesses must make critical decisions regarding how they will allocate their resources in different markets and how they will strive to gain a competitive advantage in those markets. To be successful, managers have to understand the global context within which they function. The failure to take a global perspective is one of the biggest mistakes that managers can make.

3.2 Why do Companies Global

They are several reasons why organizations would like to enter the international market and go global. Let us discuss some of the important reasons :

(i) **Lower Cost of Operation and greater profit** : An important incentive for a company to enter international business is the profit advantage. International business could be more profitable than the domestic one. One of the important reasons for foreign investment is to reduce the cost of production e.g. by taking advantage of the cheap labour. While in some cases, the entire manufacturing process of a product may be carried out in foreign locations, in some cases only certain stages of it are done abroad. Take the example of Nike which producese shoes in China, as the cost of production is far less than that in the United States.

(ii) **Opportunities for Growth and Expansion** : An important reason for going international is to take advantage of the business opportunities in other countries. MNCs are getting increasingly interested in a number of developing countries as the income and population are rapidly rising in these countries.

(iii) **Constraints in the Domestic Market** : Domestic demand constraints drive many companies towards expanding the market beyond the national border. The market for a number of products tend to saturate or decline in the advanced countries. This often happens when the market potential has been almost fully tapped. For example, Japanese automobile manufactureres cannot survive if they sell only to the Japanese markets. Another type of domestic market constraint arises from the inability to apply economies of scale. Technological advances have increased the size of the optimum scale of operation substantially in many industries, making it necessary to enter a foreign market, in addition to the domestic market, to take advantage of economies of scale. In the absence of foreign markets, domestic market constraint comes in the way of benefiting from the economies of scale in some industries. Countries like South Korea were able to set up plants which had enormous capacity and were economical only because of the demand of international markets to whom they export.

When the domestic market is very small, internationalisation is the only way to achieve significant growth. For example, Nestle derives only about two per cent of its total sales from its home market, Switzerland. Domestic recession often provokes companies to explore foreign markets. This has encouraged several Indian auto component manufacturers to explore or give a thrust to foreign markets. Even when the domestic market presents good growth prospects, foreign markets may be more attractive. For example, Indian pharmaceutical firms like Dr. Reddy's have been deriving a major part of their growth from abroad.

(iv) **Competition** : Competition may be the driving force behind internationalisation. A protected market does not normally motivate companies to seek business outside the home market. Until the liberalisation which started in July 1991, the Indian economy was a highly protected market. Not only that the domestic producers were protected from foreign competition but also domestic competition was restricted by several policy induced entry barriers, and operated by such measures as industrial licensing and the MRTP regulations. The Indian companies did not take the foreign market seriously. The economics liberalisation in India has increased competition from foreign firms as well as from those within the country since 1991. Many Indian companies are systematically going international in a big way.

(v) **Government Policies and Regulations** : Government policies and regulations may also motivate internationalisation for both positive and negative reasons. Many governments offer incentives and infrastructural support to domestic companies, to export and to invest in foreign countries. Several countries encourage import development and foreign investment. Before the 1991, New Industrial Policy ushered in liberalization in India, companies were obliged to earn foreign exchange to finance their imports and to meet cretain other foreign exchange requirements like payment of royalty, dividend, etc. In India, permission to enter certain industries by the large companies and foreign companies was subject to specific export obligation, and other regulations uptil 1991. Some companies move to foreign countries to avoid regulations, like the strict environmental laws in advanced countries. Government policies which limit the scope of business in the home country may also provoke companies to move to other countries.

(vi) **Monopoly Power** : International business sometimes results from the monopoly power which a firm enjoys internationally. Monopoly power may arise from factors like monopolisation of certain resources, patent rights, technological advantage, product differentiation, etc. Even a dominant position may facilitate internationalisation for a company. Exclusive market information is another proactive stimulus. This includes knowledge about foreign customers, market places, or market situations not widely shared by other firms. Such special knowledge may result from particular insights by a firm based on international research, special contacts a firm may have or simply being in the right place at the right time. Although such monopoly element may give an initial advantage, competitors could catch up soon.

(vii) **Benefits of entering International Market for Domestic Business** : International business may help the company to improve its domestic business by improving the image of the company. Exports may have pay-offs for the internal market too by giving the domestic market better products. Earlier in India, the foreign exchange earnings enabled a company to import capital goods, technology, etc. which were not otherwise be possible and thus improving upon overall quality and quantity of production. International Business also provides competition for the organization resulting in an overall improvement in the production.

(viii) **Strategic Vision** : Modern business organization have a larger vision towards which they systematically plan to grow. Going global is a part of this strategic vision and fuels the growth of the company. The world is seen as a single market and organizations are increasingly becoming global players.

3.3 Forces for Globalization

Many forces drive the process of Globalization. These forces encourage organization to make forays into the international markets and create a 'borderless world'. Of course, there are also many hurdles in the way of globalization which restrain organizations from entering global markets. When the problems or hurdles seen by the organization are less than the forces that propel the organization towards globalization, the natural consequence is that the organization goes global.

3.3.1 Forces that Drive Globalization

Let us discuss the driving forces :

1) **The Process of Liberalization:** The most important factor that has given a great impetus, to globalization since the 1980's is the process of economic liberalization that has swept accross world economics. Some of the liberalization, privatization and deregulation can be said to be a result of the policies of the World Bank and the IMF, others can be said to be a consequence of GATT/WTO outcomes but many are simply a change towards the 'world as one market'. Even China has brought in a unique system of economic policy changes, while the collapse of the East Bloc consisting of the socialist/communist nations of East Europe lead by erst while USSR have all opened up their markets. India itself went in for major economic policy changes through the New Industrial Policy in 1991. All these changes are creating greater global integration in the world.

2) **MNCs:** Multinational enterprises link their resources and objectives with world market opportunities, and are a powerful force driving globalisation. As a result of liberalisation there has been a fast growth in the number of MNCs and their global network of affiliates. The MNCs leverage their strengths to link global resources and opportunities and strengthen the globalisation trend.

3) **Technology :** Technology is a powerful driving force of globalisation. Technological advances have pushed for globalisation. Technology has in fact been a very important facilitating factor of globalisation, as it involves greater costs and risks. This makes it imperative for firms to tap world markets and to share these costs and risks. Falling transport and communication costs creating the "death" of distance have made it economical to integrate distant operations and ship products and components across the globe in the search of efficiency. This also contributes to efficiency-seeking FDI, with important implications for the export competitiveness of countries. Technological developments often result in internationalisation. Technological break-throughs are substantially increasing economies of scale and are vital for globalisation. The monopoly of technology, like possession of patented technology, encourages internationalisation because the firm can exploit the demand without any competition.

4) **Transportation and Communication is Faster and Cheaper Nowadays:** Technological revolution in transportation and communication, has given a great impetus to globalisation by their contribution to the reduction of the disadvantages of distance and cost. The IT revolution has resulted in the emergence of the global village. Indeed computers have vastly increased the amount of information that can be processed by individuals and firms. Global communications have been revolutionised by developments in satellite, optical fiber, and wireless technologies the internet and the World Wide Web. The developments in the field of air cargo transportation has fostered globalisation by enabling quick and safe transportation of sensitive goods (like perishables and goods subject to quick changes in fashion and taste). Developments of containerisation and refrigeration have also been of high significance. The steep fall in the cost of transportation and communication have considerably accelerated pace of globalisation. All these have contributed to the drastic transformation of the logistical and global distribution of the value chain system. The world-wide web has had a stupendous impact on globalisation. Thus, Global sourcing has been encouraged not only by trade liberalisation but also by technological developments.

5) **Product Development Costs and Efforts :** The cost of new product development is enormous in industries such as pharmaceuticals. To justify these costs a global market is essential. Fast technological changes which hasten product obsolescence, necessitate a short pay back period. This can be realized only with a very large global market. The huge investment and diverse requirements of skill associated with new product development fuel cross-border alliances in research and development. In many cases different phases of the product development are carried out in different countries either by a company's own affiliates or through outsourcing.

6) **Quality and Cost :** The two most important determinants of demand are the quality and price of the offering. These can be better achieved when a firm is global in its operations.

7) **Higher Aspirations and Wants of the Consumer :** The aspirations of people all around the world are rising. This is a result of the impact of media, greater education and mobility of consumers. If domestic firms are not able to cater to the wants, they would naturally turn to foreign goods and services. The customer today is, by and large, global. He wants a world-class product or a product of desired attributes. The consumer is also becoming more and more aware of his rights and is also more price conscious.

8) **Competition :** An important force that drives globalisation is increasing competition. It compels firms to explore new ways of increasing their efficiency. It also results in international production taking new forms, with new ownership and contractual arrangements and new activities being located in new sites abroad in order to reduce costs.

9) **World Economic Trends :** Some world economic trends, add momentum to the globalisation trend. One of the important trends is the difference in the growth rates of the economies/markets. The comparatively slow growth of the developed economies or the stagnation of some of their markets and the fast growth of a number of developing countries prompt firms of developed countries to turn to the expanding markets elsewhere. The differences in the growth characteristics exist even within the categories of developed and developing countries. Secondly, domestic economic growth

and outside opportunities reduce the opposition to globalisation. A classic example is China. China has benefitted tremendously out of foreign investment; the fast growing Chinese economy provides scope for a large number of players in the expanding market. At the same time, China is exploiting business opportunities outside the country. Economic liberalisation, characterised by deregulation and privatisation are driving Globalization.

10) **Regional Integration :** Regional integration schemes, like the European Union (EU) and North American Free Trade Agreement (NAFTA), foster the globalisation trend. A major part of global trade is intra-regional trade (i.e., trade between the members of trade blocs). These regional blocs also give an impetus to cross-border investments and financial flows.

11) **Leverages :** A global company can leverage its experience to expand its global operations. The more the number of countries it operates in, the greater could be the scope of leverage. The term 'Leverage implies- 'an advantage' that a company enojoys by virtue of the fact that it conducts business in more than one country'. A global company posseses the following four important types of leverages.

    ♦ ***Experience transfers*** : A great strength of a global corporation is the experience it can leverage for expanding or strengthening its global oeprations. It can draw on management practices, strategies, new products, advertising appeals, or sales and promotion ideas that have been tested in actual markets and apply them in other comparable markets.

    ♦ ***Scale economics*** : Cost is one of the important determinants of success. Cost advantage, in many cases, derives out of scale economies. The economies of scale have been expanding in a number of industries. To realise scale economies, it is often eseential to go after the global market.

    ♦ ***Resources utilisation*** : A major strength of a global company is its competence in sourcing the resources globally at competitive rates and more favourable terms and conditions.

    ♦ ***Global strategy*** : The global company's greatest advantage can be its global strategy. A global strategy is built on an information system that scans the world business environment to identify opportunities, trends, threats, and resources. It leverages its skills and focuses its resources to create superior perceived value for customers and achieve competitive advantage. The global strategy is a design to create a winning offering on a global scale.

3.3.2 Forces That Restrain Globalization

There are also several forces, which restrain the globalisation trend. These include several factors :-

- International business entails greater and more complex risks. For example, companies operating in two countries must be concerned with exchange rates for two currencies,
- Government policies and controls, which restrain cross-border business.
- Social and political opposition to foreign business.
- Lack of Infrastructure and Technology to support globalization.
- Differences between countries in ways of competing. Even relatively similar countries may have vastly different ways of competing which may create managerial hurdles.

- ♦ Lack of Strategic Vision. This may be referred to as 'management myopia' or 'congitive near sightedness' which is a hurdle for global orientation.
- ♦ Resistance to change. A well established organization which is successful in the domestic market may resist the pressure to go global.
- ♦ Rigid Organization. Culture Certain Organization Cultures are inflexible and cannot adapt to the changed circumstances of international markets.

3.4 International Business Decisions

A firm which plans to go international has to make a series of strategic decisions. They are shown in the following figure.:

Strategic Decisions in International Business

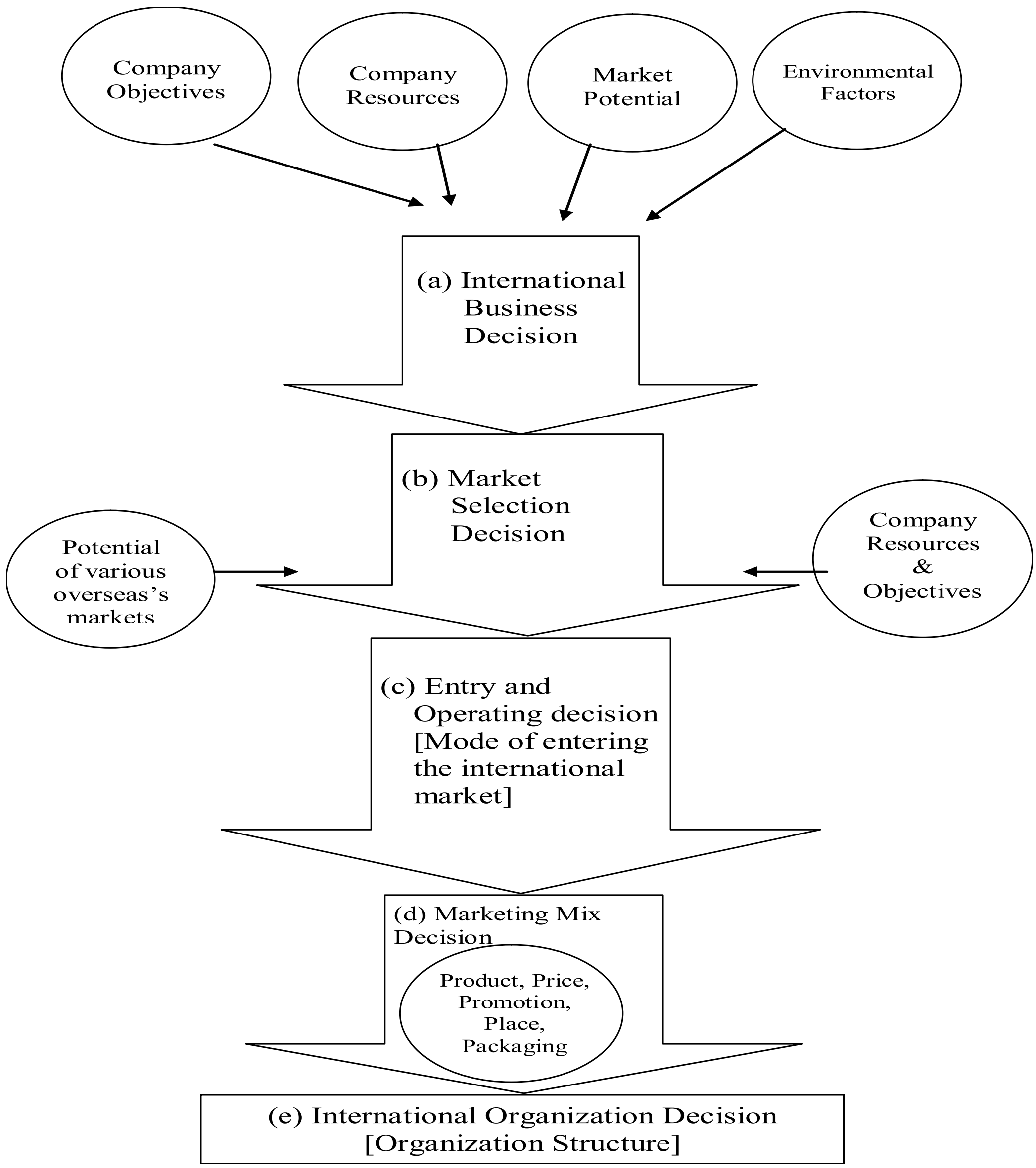

Figure 3.2

(a) International Business Decision:

The first decision a company has to make, is whether to enter international business or not. This decision is based on the consideration of a number of factors, such as the present and future overseas opportunities, present and future domestic market opportunities, the resources of the company (particularly skill, experience, production and marketing capabilities and finance), company objectives and vision etc.

(b) Market Selection Decision :

Once it has been decided to go international, the next step is the selection of the most appropriate market. For this purpose, analysis of the potential of the various overseas markets and their respective marketing environments is essential. Company resources and objectives may not permit a company to do business in all the overseas markets.

(c) Entry and Operating Decisions :

Once the market selection decision has been made, the next important task is to determine the appropriate mode of entering the international market.

(d) Marketing Mix Decision :

The international market is characterised by a number of variables. The success of international marketing, depends to a large extent on the appropriateness of the marketing mix. The elements of the marketing mix-product, promotion, price, packaging and physical distribution-should be suitably designed so that they may be adapted to the requirements of the overseas market.

(e) International Organisation Decision :

A company which wants to go international must also decide about its organisational structure. This decision should be based on a careful consideration of such factors as the expected volume of export business, the nature of the overseas market, the nature of the product, the size and resources of the company, and its previous export experience.

3.5 Modes of Entering International Markets

Managers should also recognize that their global context dictates two related but distinct sets of challenges. One set of challenges must be confronted when an organization chooses to change its level of international involvement. The other set of challenges occurs when the organization has achieved its desired level of international involvement and must then function effectively within that environment.

Thus, managing the process of Globalization essentially involves :

(i) Choosing the level of international involvement and the mode of entry into the international market.

(ii) Functioning effectively at the level of international involvement that is desired.

3.5.1 The Level of International Involvement and the Mode of Entry into Global Markets

Once the market and product/service for international expansion have been selected, an organization must decide specifically how it will enter its selected market. There are three baisc strategies for market entry. Each strategy results in greater commitment to the international venture.

Basic Strategies of Market Entry

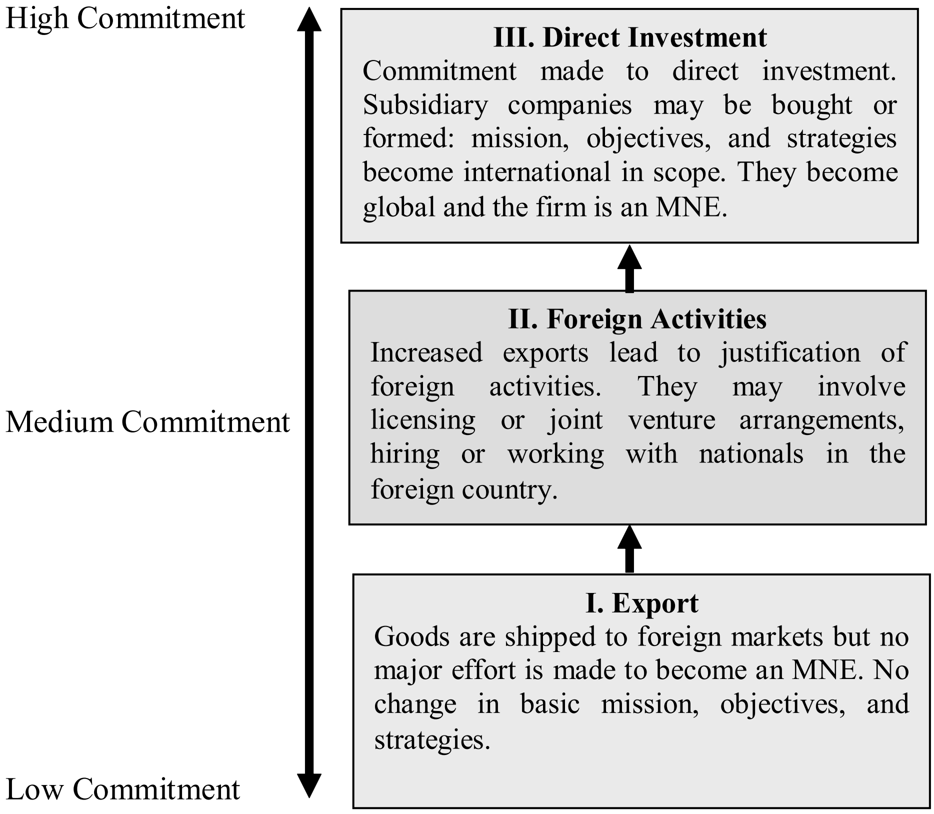

Figure : 3.3

I. Export:

Exporting involves selling a product in the global market without establishing manufacturing facilities there. Exporting encompasses promotion to stimulate demand for the product, collecting revenues, making credit arrangements from sales, and shipping the product to the market. Most companies secure an agent to handle some or all of these tasks. However, once they become accustomed to the exporting business, a number of companies assume most or all of these tasks, often establishing a staff in the host country. The export entry strategy is a very popular approach for entering international market.

In fact, the Export entry strategy is the simplest way for a firm to enter a foreign market. This strategy involves little or no change in the organization's basic mission, objectives, and strategies since it continues to produce all of its products at home. The firm usually secures an agent in the particular foreign market who facilitates the transactions with foreign buyers.

The recent trend of global outsourcing is being witnessed the world over. It involves the process of obtaining the cheapest sources of labour, raw materials, machinery or finished goods regardless of the country. Business process outsourcing (BPO) and knowledge process outsourcing (KPO) are the most recent trends in the area of Global outsourcing, while exporting involves making or sourcing a product, service or idea from the domestic market and selling it in another country, importing involves bringing a good, service or capital into the home Another concept called countertrade involves the barter of products for other products rather than selling for currency.

II. Foreign Activities:

As the importance of exports increases, the firm may decide that it now can justify its own foreign subsidiary. This decision usually involves establishing production and/or marketing facilities in the host country. The foreign subsidiary entry strategy differs from direct investment.

The Foreign subsidiary entry strategy is an approach to entry in a foreign market based on the fact that exports are increasing in importance to the firm. This decision usually involves joining with nationals in the foreign country to establish product and/or marketing facilities. It differs from direct investment in that some type of association is formed with a local firm or individual. This type of association usually takes the form of licensing, fracising or joint venture arrangements :

(a) ***Licensing*** : This involves granting a firm the right to an outside firm to produce and/or market the firm's product in another country. It is a popular method of entering foreign markets. Licenses are more often granted to businesses that existed before the license was arranged and the business serving as the licensee is expected to outlive the license contract. For example, licensees around the world have contracts to produce and sell clothing bearing pictures of 'High School Musical' or 'Hannah Montana'.

(b) ***Franchising*** : Franchising is a form of licensing which is very popular now-a-days. Pizza Hut, for example is rapidly expanding into new markets around the world via franchising agreements with local investors and managers. Pizza Hut has a presence in over 100 different countries using the concept of franchising. In this mode of entry, the oranization provides the complete package of materials and service to the foreign franchises. A franchise contract covers more aspects of the operation and are typically of a longer duration than licensing contracts. McDonald's is another good example of a corporation with franchise contracts around the world.

III. Direct Investment:

The strongest commitment to becoming a global enterprise is made when the management decides to begin producing the firm's products abroad with no association with a host country investor. The direct investment entry strategy is booming in international business in the present business scenario. Thus, the Direct investment entry strategy is a policy to begin producing a firm's products in a foreign country without the association with a host country investor. It is the strongest commitment to becoming an MNE, it enables the firm to maintain full control over production, marketing and other key functions.

The direct investment strategy may involve :

- **Strategic Alliance** : This is a cooperative arrangement between two or more firms for mutual benefits.
- **Joint venture** : This refers to an arrangement involving foreign investors who form a group with local investors to begin a local business with each group sharing ownership. The partners share the ownership of an operation on an equity basis, thus sharing both costs and risks with another firm to build a manufacturing facility develop new products or set-up a sales and distribution network.
- **Wholly owned foreign Affiliate** : This refers to a foreign subsidy over which an organization has complete control.
- **Acquistion** : This involves the acquisition of a foreign company by the organization.
- **Greenfield Venture** : This refers to a subsidary of the company which has been built from scratch in a foreign country. This is a completely new company which is set-up by the organization entering the foreign market.

When organizations decide to increase their level of Internationalisation, they can adopt several strategies. Each strategy is a matter of degree, as opposed to being a discrete and mutually exclusive category. And Each has unique advantages and disadvantages that must be considered. Let us discuss them.

Table 3.1

Advantages and Disadvantages of Different Approaches to Internationalisation

Approach to Internationalization	**Advantages**	**Disadvantages**
Outsourcing Importing or Exporting	1. Minimum foreign investment 2. Little risk 3. No adaptation necessary	1. Tariffs and taxes 2. High transportation costs and regulations 3. currency exchange 4. Government restrictions 5. Cultural Differences
Licensing and Francising	1. Increased profitability 2. Extended Profitability	1. Inflexibility 2. Competition
Strategic Alliances/ Joint Ventures	1. Quick market entry 2. Access to materials and technology	1. Shared ownership (limits control and profits)
Direct Investment : • Acquisition • Wholly owned foreign affiliate • Greenfield Venture	1. Enhanced control 2. Existing infrastructure	1. Complexity 2. Greater economic and political risk 3. Greater uncertainty

3.5.2 Strategies for Getting Started Internationally

We have seen how companies have many ways of become involved internationally. One is to seek cheaper sources of supply offshore, which is called outsourcing. Another is to develop markets for finished products outside their home countries, which may include exporting, licensing, and direct investing. These market entry strategies represent alternative ways to sell products and services in foreign markets. Most firms begin with exporting and work up to direct investment.

3.6 Functioning Effectively in a Global Market

Whether a firm is actively seeking to increase its desired level of Internationalisation or is comfortable with its present level of involvement in international levels, its managers continue to be responsible for seeing that it functions effectively within whatever level of international involvement the organization has achieved. The job of a manager in an international business may not be that much different from the job of a manager in a domestic business. Each may be responsible for acquiring resources, advertising, or monitoring cash flow and yet the complexity associated with each of these activities may be much greater for managers in international firms.

The key question that must be addressed by any manager trying to be effective in an international market is whether to focus on globalization or on regionalism. A global thrust requires that activities be managed from an overall global perspective as part of an integrated system. Regionalism, on the other hand, involves managing within each region with less regard for the overall organization. In reality, most larger MNCs manage some activities globally (for example, finance and manufacturing are commony addressed globally) and others locally (human resources). Let us now examine the concept of International orientations of companies and the managers who manage them.

International Orientations: The degree and nature of involvement in international business refers to the international orientations of companies. These orientations vary widely. Four types of attitudes or orientations towards internationalisation are associated with successive stages in the evolution of international operations. These four orientations are:

(i) Ethnocentrism (home country orientation)
(ii) Polycentrism (host country orientation)
(iii) Regiocentrism (regional orientation)
(iv) Geocentrism (world orientation)

These stages are called the EPRG scheme and are assumed to reflect the goals and philosophies of the company so far as international operations are concerned. Each leads to different management strategies and planning procedure for international operations.

• **Ethnocentric Orientation:** In the ethnocentric company. overseas operations are viewed as secondary to domestic operations and primarily as a means of disposing of "surplus" domestic production. The top management views domestic techniques and personnel as superior to foreign and as the most effective in overseas markets. Plans for overseas markets are developed in the home office, utilising policies and procedures identical to those employed in the domestic market. Overseas marketing is most commonly administered by an export department or international division, and the marketing personnel is composed primarily of nationals of home country. Overseas operations are conducted from a home country base, and there is likely to be a strong reliance on export agents. There is a tendency to employ the domestic product mix without major modifications for the overseas market.

The ethnocentric position appears to be appropriate for a small company just entering international operations, or for companies with minimal international commitments because this approach entails a minimal risk and commitment to overseas markets - no international investment is required, and no additional selling costs incrurred, with the possible exception of higher distribution costs. This position may be inappropriate for a company which wants to expand its international business significantly.

• **Polycentric Orientation:** As the company begins to recognise the importance of inherent differences in overseas markets, a polycentric attitude emerges. The prevalent philosophy at this stage is that local personnel and techniques are best suited to deal with local market conditions. Subsidiaries are established in overseas markets, and each subsidiary operates independently of the others and establishes its own marketing objectives and plans. The environment of each market is considered while formulating the marketing strategy. There is always a market segmentation, at least on a country basis. Emphasis is put on local laws, custom and culture and great care is taken to understand the local way of doing business. This usually results in the maximum degree of geographic decentralisation as local managers are recognised as being psychologically close to markets, environments and customers.

• **Regiocentric and Geocentirc Orientations**

A regiocentric company views different regions as different markets. A particular region with certain important common marketing characteristics is regarded as a single market, ignoring national boundries. Strategy integration, organizational approach and product policy tend to be implemented at regional level. Objectives are set by negotiation between headquarters and regional HQ on the one hand and between regional HQ and individual subsidiaries on the other.

A geocentric company views the entire world as a single market and develps standardised marketing mix, projecting a uniform image of the company and its products, for the global market. The business of the geocentric multinational is usually characterised by sufficiently distinctive national markets that the ethnocentric approach is unworkable, and where the importance of learning curve effects in marketing, production technology and mangement makes the polycentric philosophy less than appropriate.

Table 3.2 Comparison of Different International Orientations

Characteristic features	Ethnocentrism	Polycentrism	Regiocentrism	Geocentrism
Management orientation	• Home Country orientation	• Host country orientation	• Regional orientation	• Global orientation
Perception of the market	• Domestic market is superior • Opportunities in the similarities between the home and foreign markets • Foreign markets are extensions of domestic market	• Each national market is distinctive • The differences between the home and foreign markets are devisive	• Markets can be differentiated and delineated on the basis of common regional characteristics	• The entire world is a single market that can be effectively tapped by a standardized marketing strategy
Marketing strategy	• Extension of domestic strategy to foreign markets	• Localisation	• Trade-off between localization and standardizatio n	• Global standardization
Merits	• No cost and effort of localization • An easy route to internationalization when foreign markets/niches exist with characteristics similar to domestic market exist	• Adaptation to the market characteristi cs which help better exploitation of the market potentials	• Some of the advantages of both the localization of the market potentials	• Economies of scale and lower costs • Advantages of pace
Demerits	• Limits the scope of exploitation of the international business opportunities	• High costs of adaptation • Delays associated with adaptation	• Neglect of intra-regional differences in the business environment	• Standardisation will not be successful in many cases

3.8 International Strategies for Operating in a Global Market

Because of the complexities involved, when firms enter the international arena they generally start on a smaller scale and expand later on. Typically, firms start with low risk/low control options and then advance to higher levels of risk and control as they gain experience and build confidence. Let us examine these strategies on the basis of the level of Investment at risk and the ownership and control of Foreign Operations through the following figure.

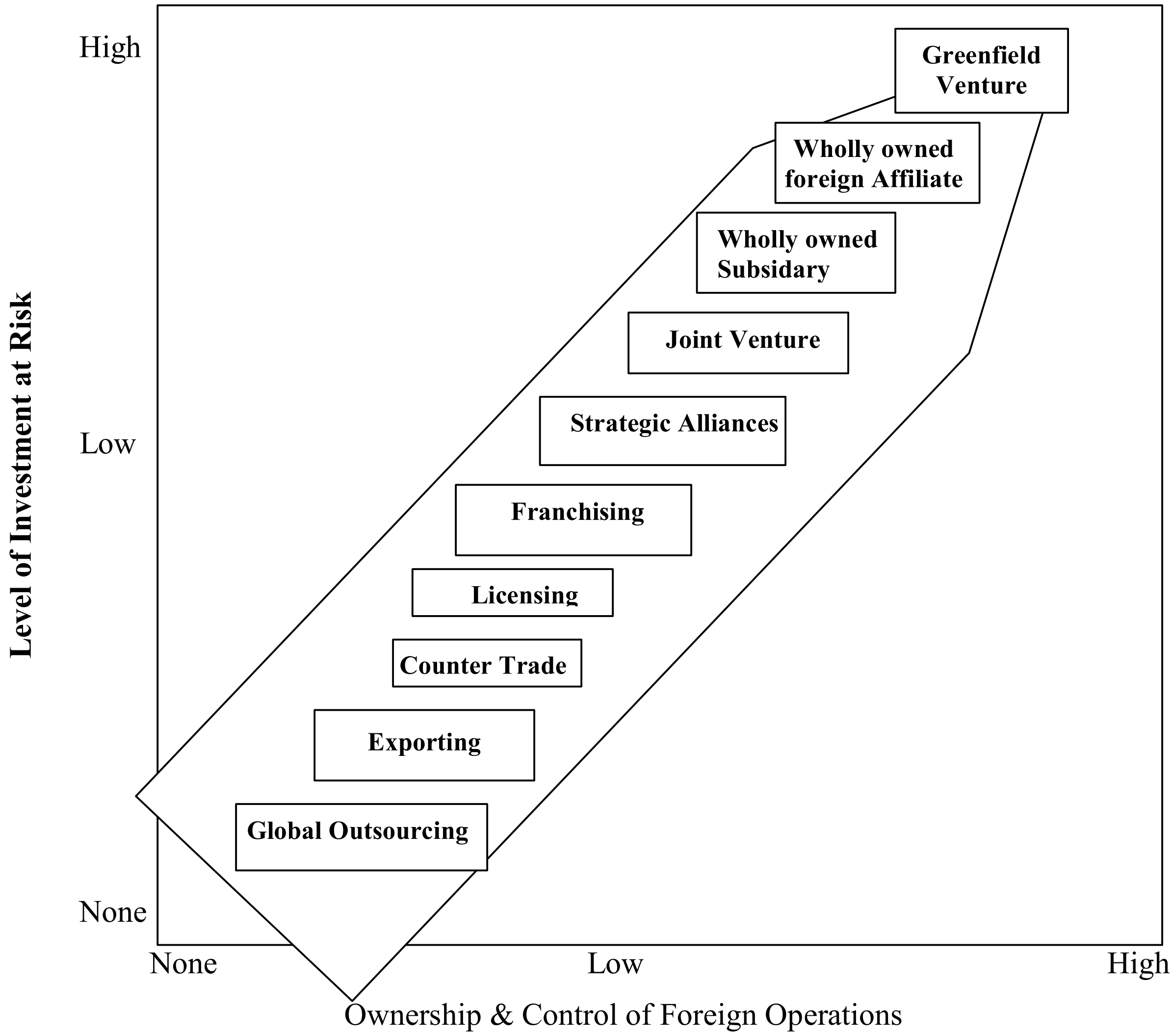

Figure 3.4 : Strategies for Entering Foreign Markets

In order to formulate international strategies two dimensions are valuable. These are :

1) **Competitive advantage** - Companies must try to achieve competitive advantage in the internatinal arena and for this must decide upon factions like :-

- Degree of differentiation
- Speed of response
- Assessment of Government relations

While businesses that operate accross national borders face many of the same competitive challanges as their domestic counterparts, they also have to face additional challenges of the political and governmental issues involved in the situation.

2) **The Integration or Standardization of the Company's operating units scattered around the world**. Companies may be following either a multi-domestic strategy, or a Global one or may be following a mix of both called a Hybrid strategy. Let us understand each of these strategies :

• **Multidomestic Strategy :** This is the way companies with multiple foreign operations that act independently of one another, operate. The country of each operation becomes its domestic market. For the on-site managers of such an operation, they are more or less an independent business focused solely on their local market.

• **Global Strategy :** In this strategy, the company operates all units under a single unifying strategy regardless of location. Here, on-site managers are scattered all across the globe and yet they see themselves as a part of a single, homogeneous world wide market. When an organization follows a global strategy strictly, adaptations to market needs are handled centrally, and the company views the entire world as one market.

• **Hybrid Strategy :** Sometimes firms need to combine the elements of both global and multidomestic strategies. This is refered to as 'thinking globally, and acting locally'.

Three Forms of Strategy for Internatiional Operations

HQ The Multidomestic Strategy-

- Units in various countries are independent.
- Each unit treats the markets as distinct from all others.
- Company headquarters are not much more than just another unit.

The Global Strategy -

- Units in various countries are under centralized control of corporate head quarters.
- Head quarters seek out standardised products suitable for variety of markets.
- Production is coordinated centrally to create economies of scale.

The Hybrid Strategy -

- Units coordinate their activities with headquarters and with one another.
- Units in various countries may adapt to special circumstances only they face.
- Entire organization draws upon relevant corporate resources, wherever they are.

3.8 Summary

The increasing level of globalization requires that organizations carefully consider their international outlook on business. Managing the process of Globalization essentially involves choosing the level of international involvement and the mode of entry into the international market and functioning effectively at the level of international involvement that the company decides upon. Three broad strategies for entering global markets can be used. Exporting involves selling a product or service in the global market without building plants and facilities. Licensing allows a partner to produce and market the firm's product in a host country. In a joint venture, a business teams up with local investors to create and operate a business in the host country. The strongest commitment to global business in when a firm produces its products abroad. The direct investment and construction of plants and facilities abroad is a statement that the business is comitted to the country and location.

3.9 Key Words

- **Market Entry Strategy :** An organizational strategy for entering a foreign market.
- **Global Outsourcing** : Engaging in international markets so as to obtain the cheapest sources of labour and supplies regardless of country is called global sourcing.
- **Exporting** : An entry strategy in which the organization maintains its production facilities within its home country and transfers its products for sale in foreign countries.
- **Importing** : Bringing a good, service, or capital into the home country from abroad.
- **Countertrade** : The barter of products for other products rather than their sale for currency.
- **Licensing** : An entry strategy in which an organization in one country makes certain resources available to companies in another in order to participate in the production and sale of its products abroad. Essentially, an arrangement whereby one company allows another company to use its brand name, trademark, technology, patent, copyright, or other assets in exchange for a royalty based on sales.
- **Franchising** : A form of licensing in which an organization provides its foreign franchisees with a complete package of materials and services. It is popular these days and involves a franchising agreement with local investors or managers.
- **Direct Investing** : An entry strategy in which the organization is involved in managing its production facilities in a foreign country. A firm headquartered in one country, builds or purchases operating facilities or subsidiaries in a foregin country.
- **Strategic alliance** : A cooperative arrangement between two or more fims for mutual gain.
- **Joint venture** : A variation of direct investment in which an organization shares costs and risks with another firm to build a manufacturing facility, develop new products, or set up a sales and distribution network. Basically the partners share ownership of an operation on an equity basis.
- **Wholly owned foreign affiliate** : A foreign subsidiary over which an organization has complete control.
- **Greenfield Venture** : The most risky type of direct investment, whereby a company builds a subsidiary from scratch in a foreign country.

3.10 Self Assessment Test

1. What does 'International Business' refer to ? What are the forms and levels of International Business?
2. Why do companies need to enter the global market place ? Discuss.
3. What are the various forces that drive Globalization?
4. Do certain factors restrain a company from entering the international business arena ? What are these forces ?
5. What are the various types of business decisions that managers entering or operating in the international market must take ?

6. Discuss the various modes of entering International Markets available for companies.

7. How can organizations function effectively and complete successfully in a Global Market ?

8. Discuss the International Strategies for operating in and competing in a Global Market.

3.11 References

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Unit - 4 : Multinational Corporations

Unit Structure:

4.0 Objectives

After studying this unit you will be able to understand

- The concept and meaning of MNCs
- The role and functions of MNCs
- The advantages and disadvantages of MNCs.

4.0 Introduction

The objective of this unit is to explain the meaning of Multi-National Corporation and to discuss the factors that contributed for the growth of MNCs, advantages and disadvantages, control over MNCs, organisation structure of MNCs, relationship between headquarters and subsidiaries, and reasons that attract MNCs in India. Today's MNCs are faced with technologically-influenced changes in global markets. Optimizing global efficiencies, national responsiveness, and worldwide learning all require MNCs to find new strategic orientations and changes in organizational capabilities. International markets are complex and volatile, requiring management to find new ways of efficiently meeting rapid changes.

The main challenge for a multinational corporation operating abroad is to exercise its rights with responsibility and fulfill its duties as a good citizen in a particular environment. In other words, to achieve and maintain a competitive and profitable business performance, while contributing effectively towards the social, economic and ecological advancement of the society where it operates. Regulatory power is increasingly exercised by autonomous non-governmental organizations. Though not lawmaking in the accepted sense, the regulatory power asserted has come to be asserted within the framework of institutionalized and self-contained systems that exercise state functions outside the state. At the same time, public law has sought to assert a measure of legislative control over private regulatory systems, especially those that seek to impose a harmonized and institutionalized regulatory framework across borders.

4.2 Objectives of MNCs

The enormous growth of international e-business that has taken place over the past three to four decades has been carried out, to large degree, by a relatively small number of very large business firms, which are called Multinational Corporation (MNC). As the name suggests, any company is referred to as a multinational corporation when that company manages its operation or production or service delivery from more than one country. Such a company is also known as international company. As defined by the International Labor Organization, a MNC is one, which has its operational headquarter based in one country with several other operating branches in different other countries. The country where the head quarter is located is called the home country whereas; the other countries with operational branches are called the host countries. Multinational corporations are companies that manufacture and market products or services in several countries by assisting the world economy. A Multi National Corporation operates a number of plants abroad and market products through a large network of fully owned subsidiaries. With the adoption of economic liberalization across the world has enormously expanded the international corporation also known as 'Transnational Corporation.'

The phenomenon of MNCs has been ascribed to a combination of two main factors: the uneven geographical distribution of factor endowments and market failure (Dunning, 1988). That is, because of their national origins, some firms have assets that are superior to those in many other countries. Moreover, a substantial proportion of these firms have concluded that they can only successfully exploit these assets by transferring them across national boundaries within their own organizations rather than by selling their right of use to foreign-based enterprises. More recently, nationally endowed assets have been supplemented by MNCs acquiring, developing and integrating strategically important assets located in other countries, thereby making their national origins somewhat less significant.

There are four categories of multinational corporations: (1) a multinational, decentralized corporation with strong home country presence, (2) a global, centralized corporation that acquires cost advantage through centralized production wherever cheaper resources are available, (3) an international company that builds on the parent corporation's technology or R&D, or (4) a transnational enterprise that combines the previous three approaches. According to UN data, some 35,000 companies have direct investment in foreign countries, and the largest 100 of them control about 40 percent of world trade. According to the parliamentary concept of Multinational Corporation, it is called the 'International Company'. Issued capital as equity or other kinds, current and fixed assets of these corporations of different countries hence, they are known as 'Heavy Capital Investment Enterprises.' "An enterprise which allocates company resources without regards to national frontiers, but is nationally based in terms of ownership and top management."

Apart from playing an important role in globalization and international relations, these multinational companies even have notable influence in a country's economy as well as the world economy. The budget of some of the MNCs are so high that at times they even exceed the GDP. (Gross Domestic Product) of a nation. These are not the sole prior causes of the Nokia, Vodafone, Fiat, and Ford Motors and as the list moves on- to flourish in India. As the basic economic data suggest that after the liberalization in 1991, it has brought in hosts of foreign companies in India and the share of U.S shows the highest. They account about 37% of the turnover from top 20 companies that function in India.

The following are the main objectives of MNCs:

1) To expand the business beyond the boundaries of a home country

2) Minimize cost of production, especially labor cost

3) Capture lucrative foreign market against international competitors

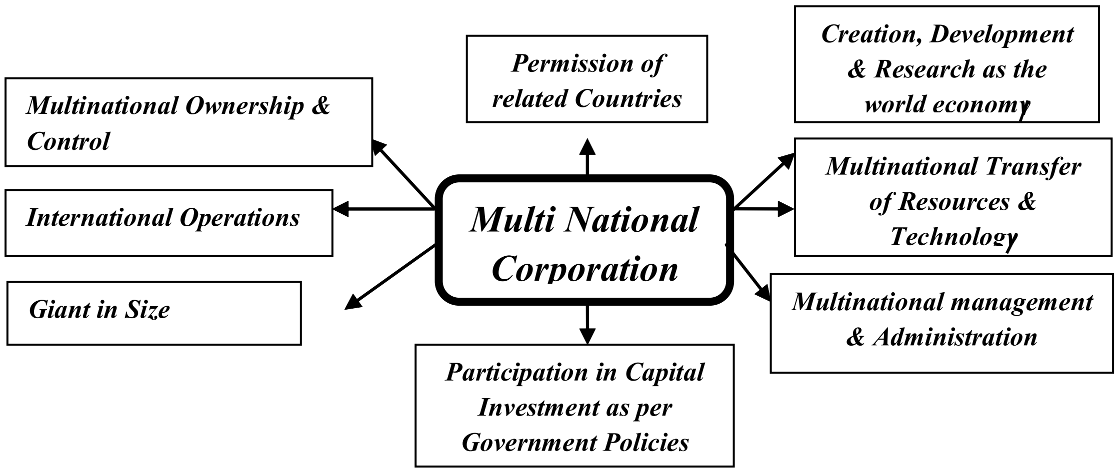
4) Make diversification internationally effective so that a steady growth of business could be achieved

5) Make best use of technological advantages by setting up production facilities abroad

6) Counter regulatory measures in the parent country

4.3 Essentials of Multi-National Corporation

Multinational corporations are the 'Owner of Intellectual and physical properties', in which sources of production, finished goods, information techniques and technology, top level managerial persons and the workers are well integrated. It is necessary for multinational corporations to take authorization from the government of that particular country where its branches or sister-concerns are recognized. Multinational are also put up with 'equity participation' which is determined by the government in position to the investment in these corporations. These may be characterized by figure 4.1 below:



Figue 4.1 : Essentials of MNCs

1. **Permission of Related Countries:** The controller on the multinational corporations is oppointed. by the department of company affairs; the Reserve Bank of India (RBI); the ministry of Industrial Development of India hence there is a need and desire to take authorization for establishment of associates (branches) from such agencies, under the rules and regulations forced by government of India, as well.

2. **Creation, Development and Research as the World Economy:** The economy profit from multinational and connection effects resulting from superior use of technology. These effects are more often not attached to change in technology, through new-patterns of development new innovations and research under world economy, including training, widening of markets and enlistment of resources.

3. **Multinational Transfer of Resources & Technology:** Multinational Corporations are rich in superior and future technology because they expand the resources and technology through incessant investigations, researches and developments as per the international norms. They have also a greater advancement in financial and other resources as the demand of 21^{st} century so they invest on research and development and develop the latest technologies, according the International Markets.

4. **Multinational Management & Administration:** MNCs have a better and skilled management system as per the standards of world economy. They have trained and intellectual persons as the

managers to plan, to systematize, to direct and to control the functioning of human and other resources. MNCs are ultimately controlled by a single managerial authority, typically the top-management groups of the parent company, which makes the key, strategic decisions relating to the operations of the parent firm and all its affiliates.

5. **Participation in Capital Investment:** The capital base of Multinational Corporation has a strong position and they have more fixed capital with financial resources and working capital so, they are under the adaptive circumstance to find out the adequate capital from the market of the host country. Foreign aid is also available to them in an easy way from the side of the government abroad. In such conditions, they remain always in profit due to the maximum and optimum utilisation of their funds.

6. **Giant in Size:** Multinational Corporations are giant business organisation. They extend their marketing activities though a network of branches or their majority owned Foreign Affiliates. These large institutions having investment and business in a number of countries, island and constituents. MNCs are earnings many a crore dollars in thousands, as profits. As an estimate, international production by Multinational Corporation numbering 63,300 parent firms with around eight lacs foreign affiliates and an excess of interim arrangements, spans virtually all countries of the world.

7. **International Operations:** A multinational corporations is an integrated world – wide business system. The parent company and its foreign affiliates act in close alliance and co-operation with one another, as distinct from functioning separately and autonomously. These corporations are controlled by a sole institution but their interests and activities (Operations) are spread out the boundaries of the nations. These companies are called as 'Global Factories' to search the opportunities.

8. **Multinational Ownership & Control:** The decisions as the MNC's overall product mix, the sourcing of inputs, including capital funds (Shares, debentures & other kinds of securities), the location of production facilities, and the markets to be served are made centrally and also controlled by the parent company, in order to take maximum advantage of cost and market opportunities in various parts of the world, to ensure interactions among the affiliates.

4.4 Factors Contributed for Growth of MNCs

The changes in the economic environment in a large number of countries, future holds out a vast scope for the growth of MNCs. Also, the rise of services to comprise the largest single sector in the world economy, regional economic integration, the globalization of firms and industries, increasing emphasis on market forces, rapidly change in technologies, and a growing role for the private sector developing countries has a weight age for development multinational corporations. In this context, several factors contributed for the growth of MNCs in detail as following:-

1. **Financial Superiorities:** Multinationals have more financial resources like immovable and working capital base is stronger. By virtue of the goodwill, they can get the benefit of foreign capital easily. Multinational Corporations enjoy financial superiorities over national companies, in addition and to market superiorities. Their resources and be used for turning the environment and circumstances in their favour. Also, they can mobilise different types of resources of high quality and may access to international banks and financial institutions.

2. **Better and Skilled Management:** Multinational Corporations are able to appoint the trained and intellectual human beings as the management superiorities, on the higher salaries, allowances and by giving the fringe benefits, when a local company is not capable to pay such attractive emoluments to their employees. Hence MNCs are most popular today.

3. **Product Innovation:** Multinational Corporations with their better and strong Research and Development Departments invent new products and develop the existing products. Developing countries suffer from such limitations. Therefore, they invite Multinationals to their countries for the development of national and to gain more revenue.

4. **Diversification or Expansion of Markets:** The growth of Gross- Domestic-production (GDP) and per capital income resulted in the rise of living standards so the large operations of the MNCs build the image, which contributed for the expansion of market territory or a wide sector for the output of inputs

5. **Efficient Technology:** MNCs are not only rich in advanced and supreme technology but also, they develop their own innovation techniques to produce and command the production and control thereon through regular investigation, research and development. They have technological superiorities due to the following instances, in reference to developing counties:

   a) Lack of adequate skilled technology in the developing countries, though they produce goods and services on their own by importing technology and materials.

   b) Developing countries are failing in marketing the products due to serve competition in international markets, so they call MNCs.

   c) When local manpower, material machines, raw-material and capital cannot optimally utilised by the developing countries on their own, they would require to import such items and for this purpose, they invite to MNCs in their countries.

   d) Developing countries are rich in minerals and natural sources but, they are not able to exploit or generate them completely due to paucity of financial (monetary) resources and poor status of technology and thereby industrialisation, MNCs are to be more inevitable in such countries.

6. **Marketing Superiorities:** Multinational Corporations are superior is marketing over the domestic companies, in the following cases:-

   a) They have a better and trained sales-force for the sale of production.

   b) They enjoy market reputation of their own.

   c) Availability of more reliable and up-to-date information about the better marketing strategies and marketing research, they have.

   d) They have more effective's sales promotion schemes, advertising with ethical norms and rapid transportation facilities.

   e) Better maintenance privileges and protection for warehousing rather than the domestic companies, in market territories.

7. **Advertisement Domination:** To increase the consumer class in a best way, Multinational Corporations expend a lot of money on the advertisement of products, in international markets, according to External strategy of the corporation. MNCs undoubtedly, carrying out business, with the ultimate objectives of profit making like any other domestic business, though the concept of business changed so widely to the present stage of relationship business, and for such purpose, to increase the relationship in between MNC and consumer, they spent about 5-12 percent of net profits on the advertisement, when local companies cannot bear such expenses so easily.

4.5 Role of Multinational Corporations

There are a number of reasons why the multinational companies are coming down to India. India has got a huge market. It has also got one of the fastest growing economies in the world. Besides, the policy of the government towards FDI has also played a major role in attracting the multinational companies in India.

For quite a long time, India had a restrictive policy in terms of foreign direct investment. As a result, there was lesser number of companies that showed interest in investing in Indian market. However, the scenario changed during the financial liberalization of the country, especially after 1991. Government, nowadays, makes continuous efforts to attract foreign investments by relaxing many of its policies. As a result, a number of multinational companies have shown interest in Indian market.

Multinational corporations (MNCs) are huge industrial organizations having a wide network of branches and subsidiaries spread over a number of countries. The two main characteristics of MNCs are their large size and the fact that their worldwide activities are centrally controlled by the parent companies. Such a company may enter into joint venture with a company in another country. There may be agreement among companies of different countries in respect of division of production, market, etc. These companies are to be found in almost all the advanced countries, with the USA perhaps the biggest amongst them. Their operations extend beyond their own countries, and cover not only the advanced countries but also the LDCs. Many MNCs have annual sales volume in excess of the entire GNPs of the developing countries in which they operate. MNCs have great impact on the development process of the Underdeveloped countries.

Let us discuss the arguments for and against the operation of MNCs in underdeveloped countries.

4.5.1 Arguments for MNCs

The MNCs play an important role in the economic development of underdeveloped countries.

1. **Filling Savings Gap:** The first important contribution of MNCs is its role in filling the resource gap between targeted or desired investment and domestically mobilized savings. For example, to achieve a 7% growth rate of national output if the required rate of saving is 21% but if the savings that can be domestically mobilised is only 16% then there is a 'saving gap' of 5%. If the country can fill this gap with foreign direct investments from the MNCs, it will be in a better position to achieve its target rate of economic growth.

2. **Filling Trade Gap:** The second contribution relates to filling the foreign exchange or trade gap. An inflow of foreign capital can reduce or even remove the deficit in the balance of payments if the MNCs can generate a net positive flow of export earnings.

3. **Filling Revenue Gap:** The third important role of MNCs is filling the gap between targeted governmental tax revenues and locally raised taxes. By taxing MNC profits, governments are able to mobilize public financial resources for development projects.

4. **Filling Management/Technological Gap:** Fourthly, Multinationals not only provide financial resources but they also supply a "package" of needed resources including management experience, entrepreneurial abilities, and technological skills. These can be transferred to their local counterparts by means of training programs and the process of 'learning by doing'.

   Moreover, MNCs bring with them the most sophisticated technological knowledge about production processes while transferring modern machinery and equipment to capital poor LDCs. Such transfers of knowledge, skills, and technology are assumed to be both desirable and productive for the recipient country.

5. **Other Beneficial Roles:** The MNCs also bring several other benefits to the host country.

(a) The domestic labour may benefit in the form of higher real wages.

(b) The consumers benefits by way of lower prices and better quality products.

(c) Investments by MNCs will also induce more domestic investment. For example, ancillary units can be set up to 'feed' the main industries of the MNCs

(d) MNCs expenditures on research and development(R&D), although limited is bound to benefit the host country.

4.5.2 Arguments against MNCs

There are several arguments against MNCs which are discussed below.

1. Although MNCs provide capital, they may lower domestic savings and investment rates by stifling competition through exclusive production agreements with the host governments. MNCs often fail to reinvest much of their profits and also they may inhibit the expansion of indigenous firms.

2. Although the initial impact of MNC investment is to improve the foreign exchange position of the recipient nation, its long-run impact may reduce foreign exchange earnings on both current and capital accounts. The current account may deteriorate as a result of substantial importation of intermediate and capital goods while the capital account may worsen because of the overseas repatriation of profits, interest, royalties, etc.

3. While MNCs do contribute to public revenue in the form of corporate taxes, their contribution is considerably less than it should be as a result of liberal tax concessions, excessive investment allowances, subsidies and tariff protection provided by the host government.

4. The management, entrepreneurial skills, technology, and overseas contacts provided by the MNCs may have little impact on developing local skills and resources. In fact, the development of these local skills may be inhibited by the MNCs by stifling the growth of indigenous entrepreneurship as a result of the MNCs dominance of local markets.

5. MNCs' impact on development is very uneven. In many situations a MNC activity reinforces dualistic economic structures and widens income inequalities. They tend to promote the interests of some few modern-sector workers only. They also divert resources away from the production of consumer goods by producing luxurious goods demanded by the local elites.

6. MNCs typically produce inappropriate products and stimulate inappropriate consumption patterns through advertising and their monopolistic market power. Production is done with capital-intensive technique which is not useful for labour surplus economies. This would aggravate the unemployment problem in the host country.

7. The behaviour pattern of MNCs reveals that they do not engage in R & D activities in underdeveloped countries. However, these LDCs have to bear the bulk of their costs.

8. MNCs often use their economic power to influence government policies in directions unfavourable to development. The host government has to provide them special economic and political concessions in the form of excessive protection, lower tax, subsidized inputs, and cheap provision of factory sites. As a result, the private profits of MNCs may exceed social benefits.

9. Multinationals may damage the host countries by suppressing domestic entrepreneurship through their superior knowledge, worldwide contacts, and advertising skills. They drive out local competitors and inhibit the emergence of small-scale enterprises.

4.5.3 Evolution of MNCs

The dynamics of international business created a great need for the evolution of Multinational Corporation. The multinational corporation is a company engaged in producing and selling goods or services in more than one country. It normally consists of a parent company located in the home country and few or more foreign subsidiaries. Some MNCs have more than 100 foreign subsidiaries scattered around the world. It is the globally coordinated allocation of resources by a single centralized management that differentiates the multinational enterprise from other firms engaged in international business.

MNCs make decisions about market-entry strategy; ownership of foreign operations; and production, marketing, and financial activities with an eye to what is best for the corporation as a whole. The true multinational corporation emphasizes group performance rather than the performance of its individual parts. There are different types of multinational companies, such as;

a) Raw-Material Seekers: Raw-material seekers were the earliest multinationals and their aim was to exploit the raw materials that could be found overseas. The modern-day counterparts of these firms, the multinational oil and mining companies such as British Petroleum, Exxon Mobil, International Nickel, etc.,

b) Market Seekers: The market seeker is the archetype of the modern multinational firm that goes overseas to produce and sell in foreign markets. Examples include IBM, Toyota, Unilever, and Coca-cola.

c) Cost Minimization Company : Cost minimizing is a fairly recent category of firms doing business internationally. These firms seek out and invest in lower-cost production sites overseas (for example, Hong Kong, Malaysia, Taiwan, and India) to remain cost competitive both at home and abroad.

4.5.4 Advantages and Disadvantages of Multinational Corporations

Multinational Corporations no doubt, carryout business with the ultimate object of profit making like any other domestic company. According to ILO report "for some, the multinational companies are an invaluable dynamic force and instrument for wider distribution of capital, technology and employment; for others they are monsters which our present institutions, national or international, cannot adequately control, a law to themselves with no reasonable concept, the public interest or social policy can accept. MNC's directly and indirectly help both the home country and the host country.

(1) Advantages of MNC for the host country:

MNC's help the host country in the following ways

1. The investment level, employment level, and income level of the host country increases due to the operation of MNCs
2. The industries of host country get latest technology from foreign countries through MNCs
3. The host country's business also gets management expertise from MNCs
4. The domestic traders and market intermediaries of the host country gets increased business from the operation of MNCs
5. MNCs break protectionalism, curb local monopolies, create competition among domestic companies and thus enhance their competitiveness.
6. Domestic industries can make use of R and D outcomes of MNCs

7. The host country can reduce imports and increase exports due to goods produced by MNCs in the host country. This helps to improve balance of payment.
8. Level of industrial and economic development increases due to the growth of MNCs in the host country.

(2) Advantages of MNC for the home country:

MNC's home country has the following advantages.

1. MNCs create opportunities for marketing the products produced in the home country throughout the world.
2. They create employment opportunities to the people of home country both at home and abroad.
3. It gives a boost to the industrial activities of home country.
4. MNCs help to maintain favourable balance of payment of the home country in the long run.
5. Home country can also get the benefit of foreign culture brought by MNCs

(3) Disadvantages of MNC for the host country:

1. MNCs may transfer technology which has become outdated in the home country.
2. As MNCs do not operate within the national autonomy, they may pose a threat to the economic and political sovereignty of host countries.
3. MNCs may kill the domestic industry by monopolising the host country's market.
4. In order to make profit, MNCs may use natural resources of the home country indiscriminately and cause depletion of the resources.
5. A large sums of money flows to foreign countries in terms of payments towards profits, dividends and royalty.

(4) Disadvantages of MNC for the home country :

1. MNCs transfer the capital from the home country to various host countries causing unfavourable balance of payment.
2. MNCs may not create employment opportunities to the people of home country if it adopts geocentric approach.
3. As investments in foreign countries is more profitable, MNCs may neglect the home countries industrial and economic development.

4.6 Structure of Multinational Corporations

Organization is only a means to an end. It takes certain inputs from the environment and converts them into specified outputs desired by the societies of the nation, according to the style, culture and fashion adopted by the people. They are economic and social entities in which a number of persons perform different tasks in order to achieve common goals.Organization design deals with structure aspects of undertakings, to perform the roles, responsibilities and relationship so that collective efforts can be done.

Organization design is the process of systematic and logical grouping of activities, delegation of authority and responsibility, with establishing working relationships that will enable both the company and employee to realize their mutual objectives. Hence, it is to explain that in creation of designing the organization (i.e. Multinational Corps.), the relationships involving exercise of authority and exchange of information's, between such units and positions which leads to development of an organization structure, is to pursue.

What Steps may be taken for Organization Designing?

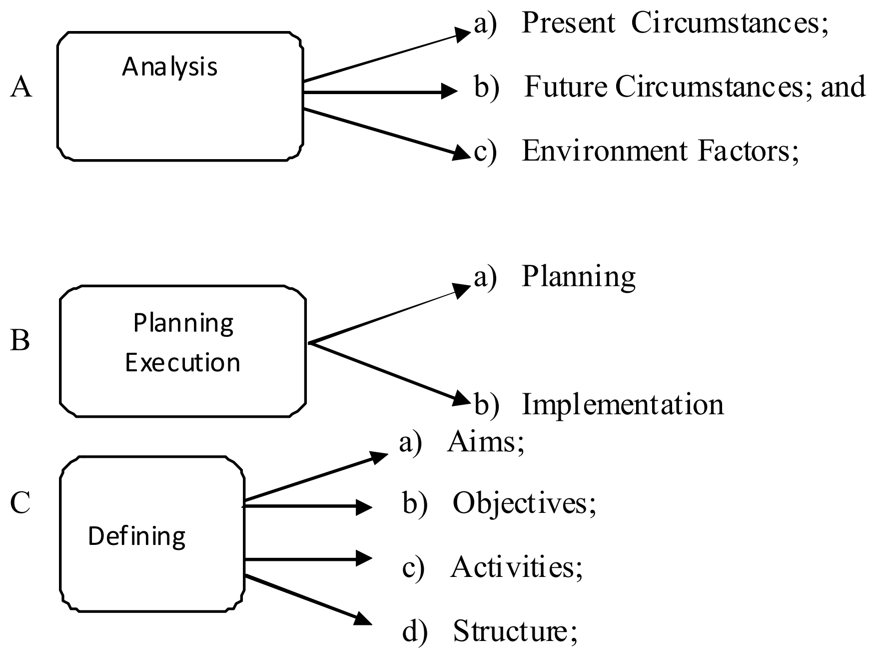


Figure 4.1

The structure of organization of a Multinational Corporation may be designed on the basis of two alternatives

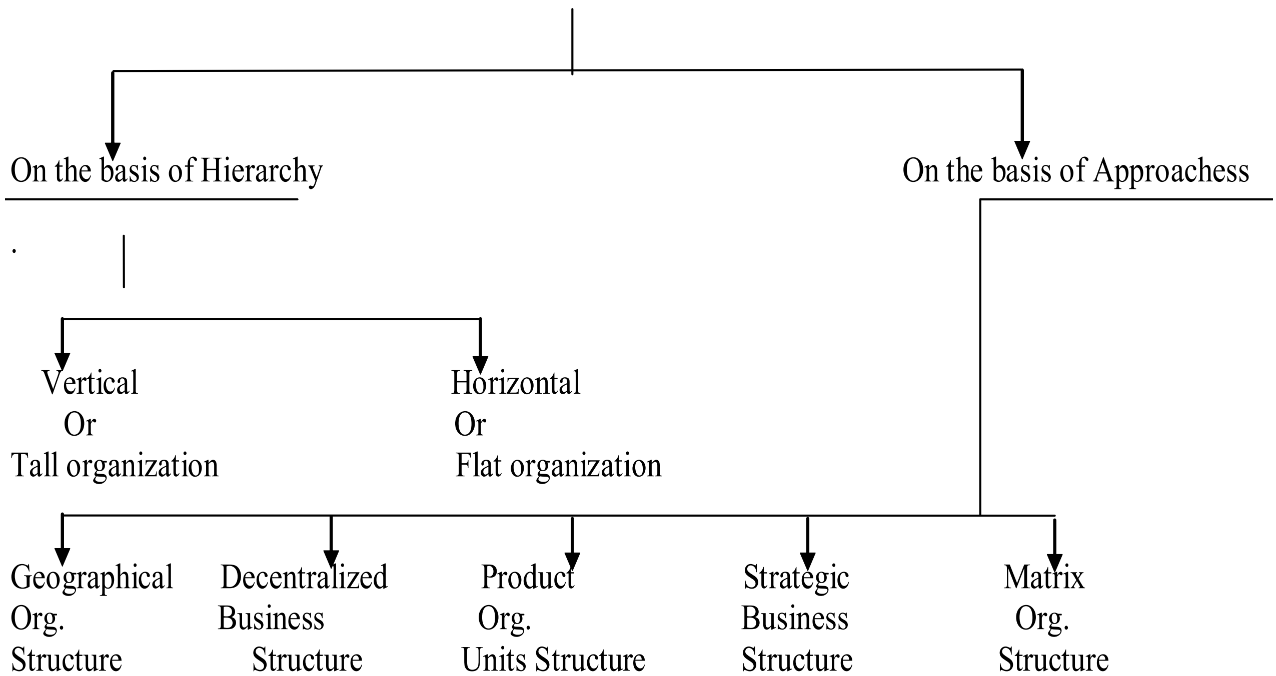


Figure 4.1

A. On the basis of Hierarchy:

When the hierarchical chain of command of a MNC represents its authority and responsibility relationship between superiors and subordinates, may be divided into two parts-

(i) Vertical or Tall Organisation: These organizations refer to authority responsibility flow from the top to bottom through all levels of hierarchy. Accountability (Responsibility) flows from the lowest level (grass-root-level) to the highest level (decision/policy making level). The blue-collar men (Employee), at each level of the organization shall report to their immediate boss, who in turn should report to his superior, to the top level. A significant characteristics of such MNC organization is "Centralisation of Authority".

(ii) Horizontal or Flat Organization: In such structure of MNC organization, authority is more decentralised in relatively flat structures.

- Managers granted more authority to his subordinates;
- They to an increase in breadth of an organization's structure;
- Professional managers are treated as real professionalist;
- They reduce the number or hierarchical levels of their organizations of MNC's;
- Managers have a broad span of control with a dignity and empowerment; and
- Decisions are more likely to be made by the employees who are at the helm of affairs with the situations and ground realities.

B. On the basis of Approaches:

(i) Geographical Organization Structure: This is a type of Multinational Corporation where the functions or activities are divided in groups or in departments, based on the crucial functions, performed in the geographical regions or areas. Also –

- Each geographical unit bears all functioning required from production to marketing and after services, in particular geographical areas;
- This structure is used mainly by 'Chain-stores', 'Power Companies', 'Banking Companies', 'Insurance Companies', 'Dairy Products', and 'Restaurant Chains' etc.

The following figure explains it clearly –

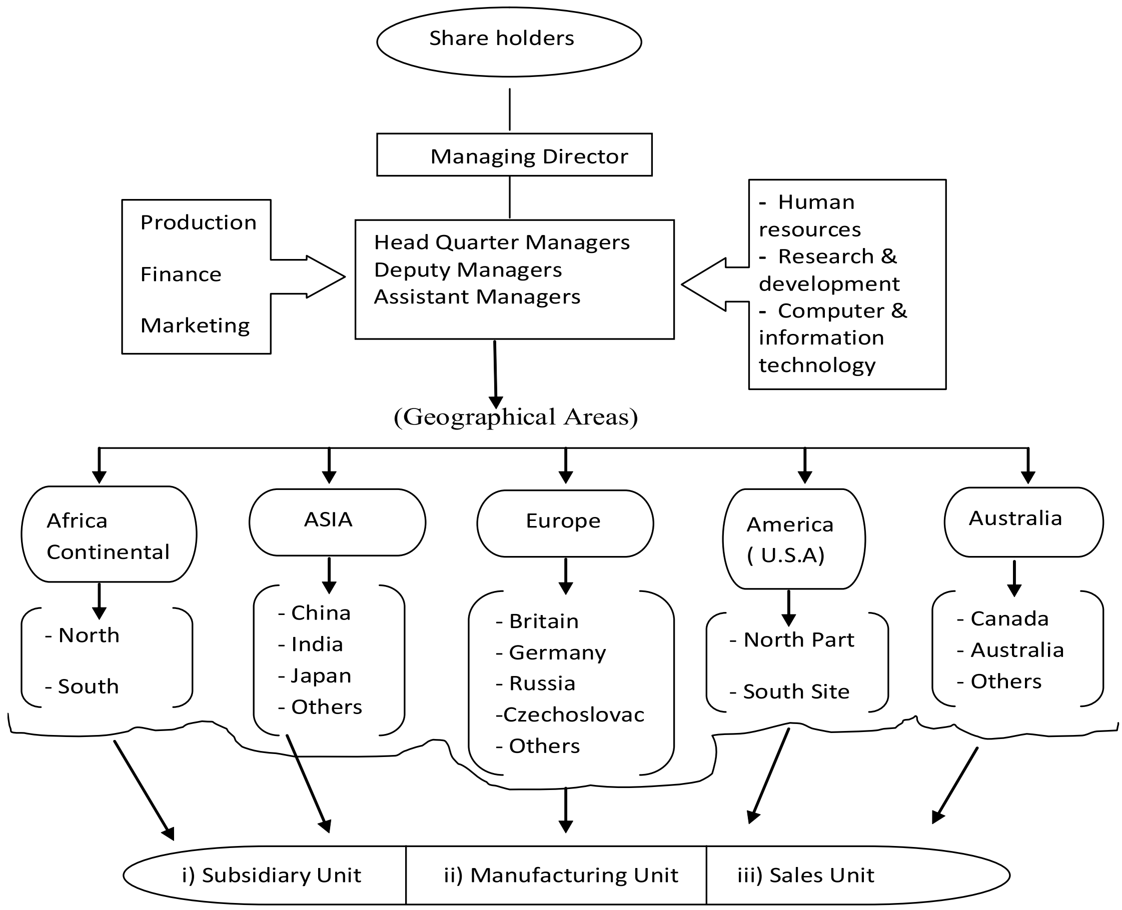


Figure 4.9

Main Advantage of Geographical Orgranization Structure of MNCs:

i. It allows a firm (MNCs) to respond to the technical needs of different part of International area;

ii. Where the good (Product) and services are better designed, as the climate, cultural and social needs of various geographical region;

iii. Such structure enables a company (MNC) to adapt various legal systems of different nations ;and

iv. The global location may give the MNC, an opportunity to better serve the consumer needs, in a better way, to the people of different countries, gaining a high profit according to the style and fashions of them.

Disadvantages:

i. Such organisational structure has some limitations of freeness, to appoint functional personal;

ii. There may be duplication human resources, equipments and facilities;

iii. You cannot seek the co-operation in between the company –wide activities i.e. it would be difficult; and

iv. If there is any misunderstanding about uniformity and diversity, it shall be difficult to maintain consistent company (MNC) good will or its reputation in international markets.

b). Decentralized Business Unit Structure: In this structure of MNCs:-

i. Grouping functions and activities based on the product-line, with a trend among the diversified companies;

i.

ii. The fundamental organisational building blocks are its business units, which are decentralised as a whole in the organisation (MNC); and

iii. Each and every business unit is operated as a stand-long profit centre, by decentralisation decision making and delegating authority.

Advantages:

1. There is a decentralised decision-making.
2. Delegation of authority and responsibility to a manager is for a separate business unit;
3. Each and every business unit is separate profile centre, as a standalone;
4. According to the key activities, strategy and operating requirements, each business unit may establish either the functional or geographical bases;
5. Every business unit is to manage by an entrepreneur or entrepreneurship oriented manager; and
6. Such manager is delegated with authority to make and implemented the business policies, rules programmes, budget and strategies to fight with the competitions.

Disadvantages:

There may be many lacunas in any system of organisational structure. In this context, decentralised business unit structure has a some demerits (disadvantage) also, explained as following:-

1. There is an absence of a systematic mechanism by which may coordinate to the activities across business units; and

2. Chief or general manager of each business unit functions independently hence, he may be autocratic leader rather than democratic leader and that may be harmful to MNC.

The decentralised business unit structure may be understood through following figure:-

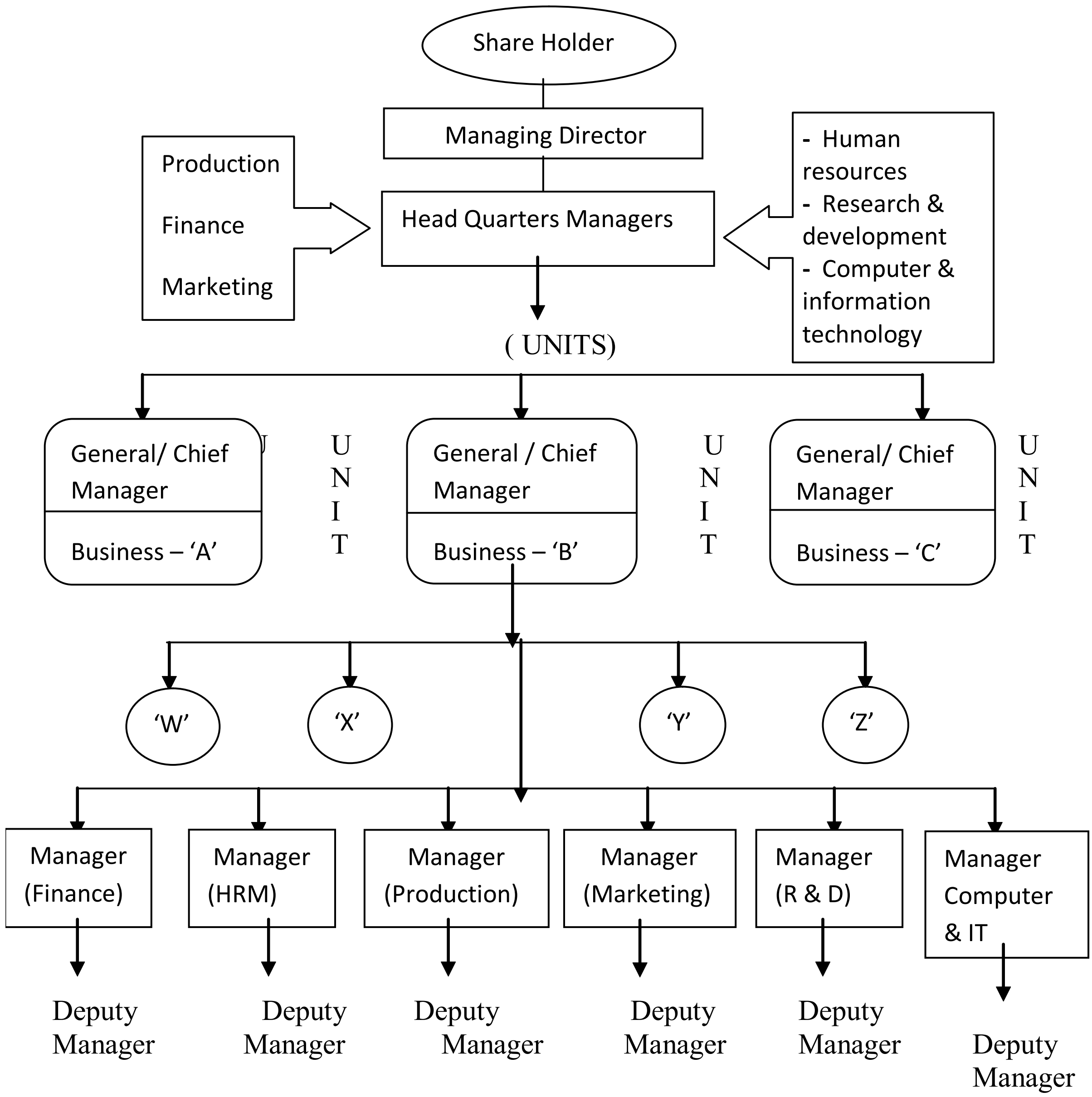


Figure 4.4

(c) Product Organisation Structure:

This is a kind of MNC organisation where activities are divided on the basis of individual product, product line; services related to them are grouped into departments. All managerial functions i.e. production, finance, marketing, human resource and research & development are involved within each department.

To classify the above statement, it is to say that –

i. Product are categorised by their nature and utility;

ii. Each product is a output of the efforts different managerial departments;

iii. Each managerial function has it share as per pre-determined decision, taken by Managing Director, on behalf of Board of Directors of Multinational Corporation.

Advantages:

1. The product organization structure is more appropriate for those multinational companies producing different types of the products (multiple-product);

2. The decision are taken by each product department, without taking the help of top management;

3. Each separate product department is responsible and accountable for market share, sales returns, profit and loss fixed by the top management in its strategies. The success or failure of a product launching and for gaining the markets is depend separately to each department.

Disadvantages:

1. There is a lack of specialisation due to the duplication of personnel and equipments among different product departments;

2. Inter – departmental conflicts may arise regarding sharing or allocation of overhead expenses and various resources; and

3. The decision for salaries, promotion, transfer, product, designing and quality and pricing strategy may be inconsistent, in between the departments, relating to the product.

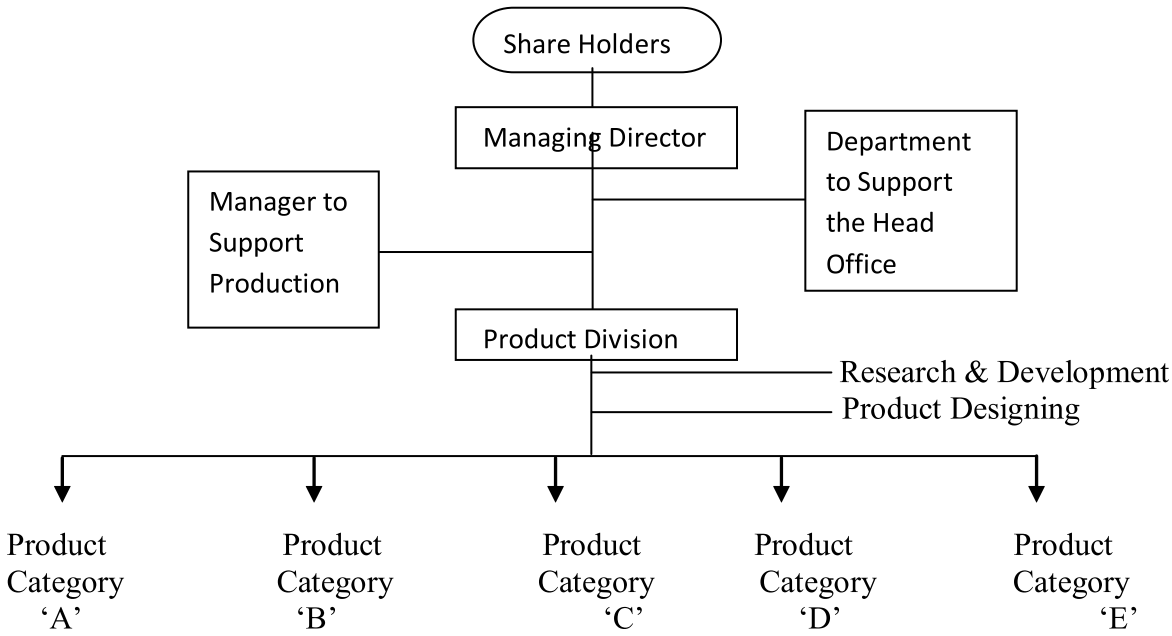


Figure 4.5

d) Strategic Business Unit Structure:

To control the business effectively, it is necessary to make a good strategy. A single CE (chief executive) is not enable to control, a number of decentralised units of a broadly diversified corporation, but if the concerning businesses are grouped into strategic units and the senior and experienced executive is delegated with the authority and responsibility for its administration, management and control, the arrangement shall improve strategic planning and implementation. It may be understand by following figure 6:

Advantages:

1. SBU structure promote more cohesiveness (mutual co-operation) in between the new initiatives of related business;

2. It helps in allocation of corporate resource to areas with best growth opportunities;

3. It provides a strategically relevant path to manage the business units of a broadly diversified corporation; and

4. SBU structure allows for a long term strategies planning to be done at the most relevant level within the total undertaking.

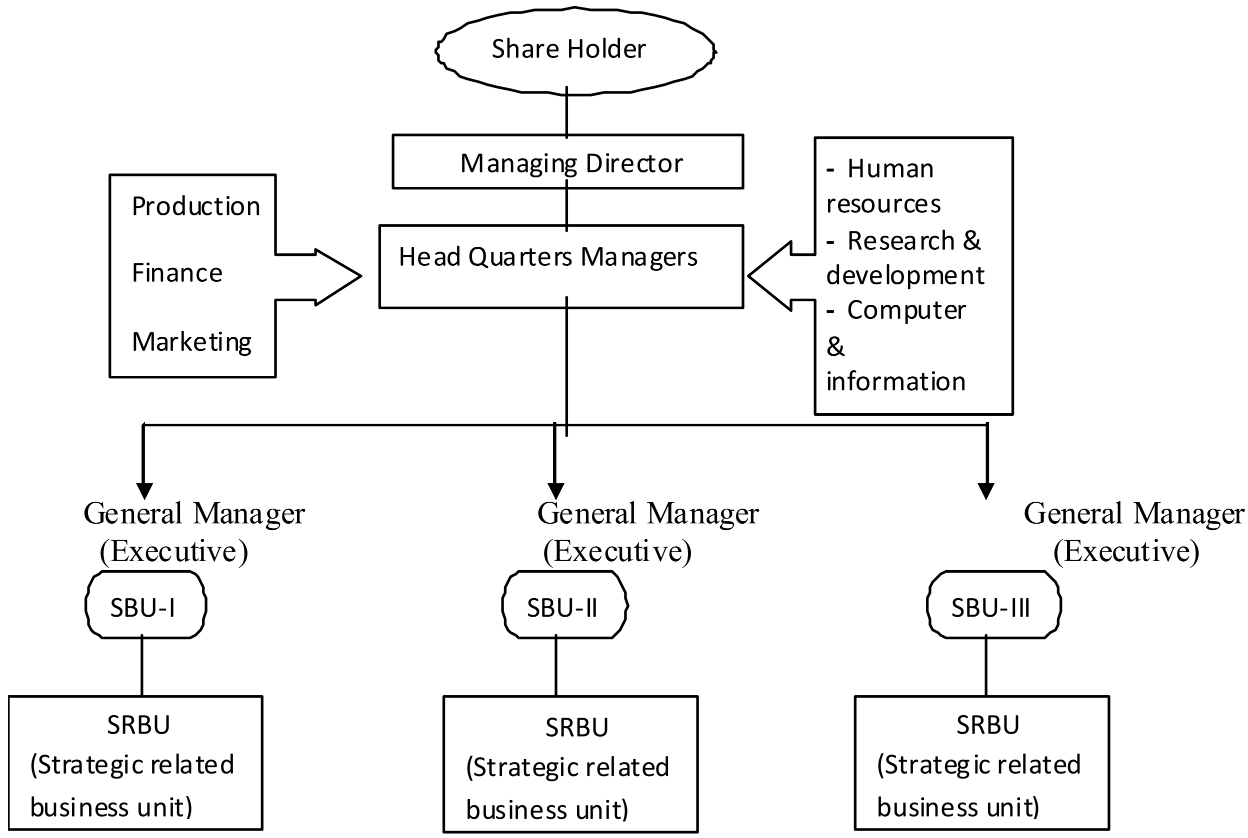


Figure 4.6

e) Matrix organization Structure:

The organization structure which possesses the characteristics of functional and project management, where the managers exercise authority over organizational activities is called matrix organization. Such structure has dual chain of command.

In an appropriate matrix organizational pattern of MNC-

a) Management attention must be focused on consumer needs and technical issues i.e. key issues;

b) Diverse information need to be processed in between the functional and project staff.

Advantages:

1. Functional and project manager give the formal attention to each instance and dimension of strategic primacy;

2. The decisions are taken on the basis of the best efforts for the organisation, as a whole;

3. In such structure, there may be efficient use of functional expertise; and

4. It facilitates operation in dynamic and complex environment, by encouraging optimisation of organisation goals.

Disadvantages:

1. It is a very complex organisation where management is too difficult;
2. There may be a conflict in between functional and Project Manager for their status; and
3. Share Holder

It promotes an internal bureaucracy in the corporation by which decision taken may be delayed.

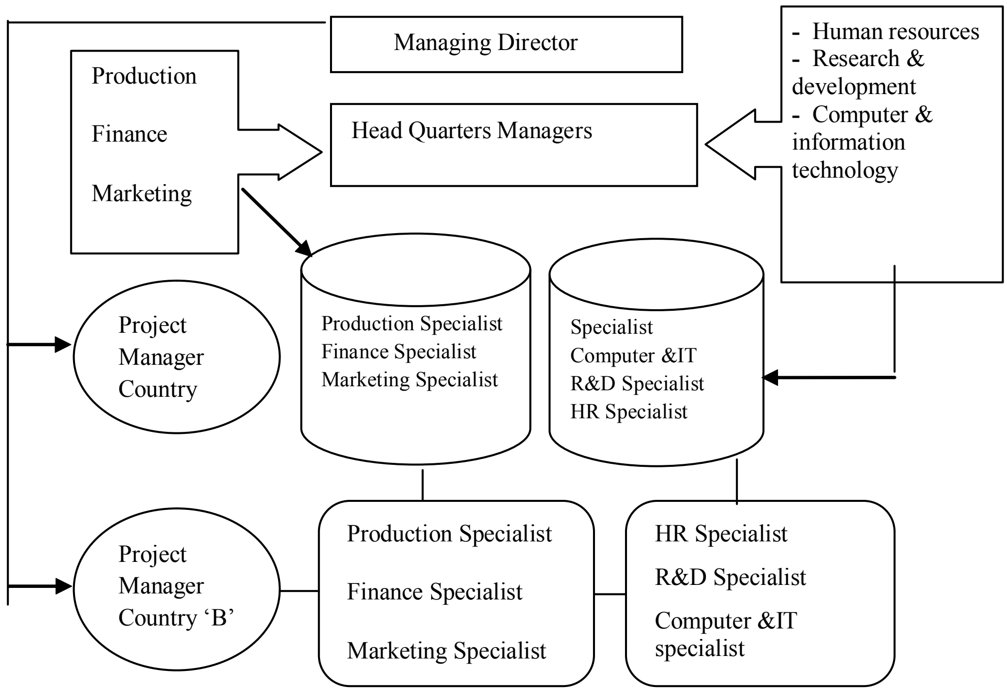


Figure 4.7

4.7 Relationship between Head Quarter and Subsidiaries

Any multinational corporation which have a few subsidiaries can be managed directly and easily, but when subsidiaries are more, it must make a permanent relationship in its structure, be co-ordinate and controll the activities, to provide and implement the information technology. There are 'six aspects' of relationship between Head quarter and subsidiaries, as following-

1. **Resources Sharing :** MNC head quartar and its subsidiaries, also participate and share different type of resources in between them, just like human, material, machine, markets, information and technology with new innovations, for their improvement.
2. **Strategy Formulation :** The MNC headquarter formulates the global strategies to co-operate the subsidiaries, for their countries where they are running the business. Also, MNC HQs guide and direct them in evaluation, implementation and motivation of strategies, regularly
3. **Information Sharing:** In between the MNC headquarter and Subsidiaries, Information flows both directions, viz HQ receives the information from the branches relating to their demand, daily sales, financial situations, about markets, customer's difficulties, environment of host and abroad country and for product design etc. and similarly, the subsidiaries get the information from the MNC HQs regarding the total record of human resources.
4. **Co-ordination of Activities :** Multinational Corporation's headquarters coordinates the activities of subsidiaries and suppliers, market intermediaries, bankers, foreign governments, custom and excise officials and different external parties, demand and supply of human resources, finance for subsidiaries.

5. **Control of Operations :** The MNC headquarter as a status that they are controlling authority of subsidiaries, to control on competitor's positions, customs and excise regulations, govt. policies and rules, laws relating to business, terms and conditions decided by suppliers of raw-material and the contracts made with the financial institutions, so on.

6. **Decisions Flows :** Mainly, policy making and decision making is the job of MNC HQ. When HQ has taken the decision, it flows to the subsidiaries to communicate and implement them. Similarly, subsidiaries communicate the decisions made by them, for creation the working process and to plan for implementation, for approval.

4.8 Control of Multinational Corporations

Multinational Companies have become very large and very powerful. Some, for example, are worth more than the entire GDP of many countries. So MNCs can have an enormous effect, for good and for ill, on the countries they do business in, especially if those countries are small and/or poor. This revision note examines the main areas of influence:

(1) The Balance of Payments:

MNCs import large amounts of capital in order to pay for their new business investments; factories, offices or whatever. This surplus on the capital account creates a deficit on the current account i.e. the country is importing more goods and services than it is exporting. This lifts local standards of living until the import of capital stops for whatever reason and then standards fall again. If the new business is for import substitution (producing locally what had been imported) then imports fall and the current account improves. If the new business is developing local raw materials for export (eg oil exploration) then the exports of raw material also improve the current account.

But, the MNC may need to import large amounts of technical equipment not available locally, and this will worsen the current account. If the MNC re-invests its profits then there is no effect on the Balance of Payments, but if it repatriates its profits, the current account worsens. Further, the exchange market of a small country may not be well-developed, so the attempt by a business to buy or to sell large amounts of foreign exchange will send the price of that currency sharply up or down unless things are managed very carefully

(2) Employment:

Generally, MNCs set up new businesses which need new workers and so employment is improved; jobs are created. However, it depends on the skills match between the new jobs and the local employment market. The business may set up a factory specifically designed to suit the local employment market. But in the Middle East oil states, for example, there are many factories producing for the local consumer markets. Sometimes the jobs are too demanding for the locals, and sometimes the jobs are too demeaning. Either way, the result is huge numbers of expatriate workers from India, Bangladesh, the Philippines and so on and at the same time large local unemployment.

But, MNCs can sometimes provide devastating competition for local businesses which may end up closing which creates unemployment. MNCs usually employ fewer workers; that is part of their greater efficiency. The MNC may then relocate again after a period of years.

(3) Technology Transfer:

An MNC invariably operates to a higher standard of managerial and technical expertise than the local economy. Local employees can learn about these things and the local economy can benefit from this new expertise. Even the UK can benefit, so we are not simply talking about developing countries where technology transfer is enormously important. This will depend on how willing the MNC is to employ and train local workers.

(4) Social Responsibility:

Standards and regulations are another kind of business cost, and MNCs are always looking for lower costs. So there is an advantage to locating in countries with few regulations. Some poor countries are prey to corruption and bribery which means their few regulations are ineffective. India, for example, has excellent environmental protection laws, on paper. In practice, the inspectors are so badly paid it only costs a matter of dollars to get them to look the other way. This opens the way for a slippage of standards below the levels considered acceptable in the MNCs home country.

One of the most scandalous cases was in the 1980s where the US chemical business Union Carbide tolerated very poor safety standards at a factory in Bhopal, India.. The result was an explosion which released clouds of toxic gas and killed thousands. Many more thousands are still alive and very ill because of this. What was particularly irresponsible was the long years it took to force Union Carbide to accept responsibility and pay compensation. This whole area is a large and important are which it is impossible to cover completely. It is, for example, one important reason why some western pressure groups are so hostile to MNCs.

(5) Government Control:

It is quite difficult for some governments to exercise effective control over MNCs because they are so large and powerful. One MNC may be the dominant force in the local economy. Even large and wealthy countries such as the UK can’t always control MNCs effectively. They have a wide repertoire of tricks to minimize government control, especially taxes.

One favorite trick (technically illegal) is transfer pricing. MNCs often buy and sell between different national offices of the same business, because each is a separate profit centre. For example, the Paris office makes the product, and the Berlin office sells it. So the Paris office has to sell to the Berlin office. There is then the question of at what price the sale takes place. Officially, the selling price must be the market price on the day, but some markets don’t have prices every day, and governments have a difficulty in proving what is going on.

If, for example, German company taxes are higher than French company taxes, then the Berlin office will pay too much for the product and make a loss. The Paris office makes a very large profit and pays tax on this profit at the lower rate. When different governments have completely different tax systems, with thousands of detailed rules of how tax is paid, and deductions for this, and allowances for that, the opportunities for MNCs to employ a few clever tax accountants and ‘cook the books’ are enormous.

4.9 Top MNCs in India

The country has got many MNCs operating here. Following are names of some of the most famous multinational companies, who have their headquarters of operational branches based in the nation:

IBM: IBM India Private Limited, a part of IBM has been operating from this country since the year 1992. This global company is known for invention and integration of software, hardware as well as services, which assist forward thinking institutions, enterprises and people, who build a smart planet. The net income of this company post completion of the financial year end of 2010 was $14.8 billion with a net profit margin of 14.9 %. With innovative technology and solutions, this company is making a constant progress in India. Present in more than 200 cities, this company is making constant progress in global markets to maintain its leading position.

Microsoft: A subsidiary, named as Microsoft Corporation India Private Limited, of the U. S. (United States) based Microsoft Corporation, one of the software giants has got their headquarter in New Delhi. Starting its operation in the country from 1990, this company has got the following business units:

- Microsoft Corporation India (Pvt.) Limited (Marketing Division)
- Microsoft Global Services India
- Microsoft Global Technical Support Centre
- Microsoft India Development Center
- Microsoft IT
- Microsoft Research India

The net income of Microsoft Corporation grew from $ 14, 569 million in 2009 to $ 18, 760 million in 2010. Working in close association with all the stakeholders including the Government of India, the company is committed towards the development of the Indian software as well as I. T industry.

Nokia Corporation: Nokia Corporation was started in the year 1865. Being one of the leading mobile companies in India, their stylish product range includes the following:

- Normal mobile handsets
- Smartphones
- Touch screen phones
- Dual sim phones
- Business phone

The net sales of the company increased by 4 % in the last financial year with sales of EUR 42.4 billion as compared to 2009's EUR 41 billion. Over the past few years, this company in India has been acquiring companies, which have got new and interesting competencies and technologies so as to enhance their ability of creating the mobile world. Besides new developments to fight against mineral conflicts, they are even to set up Bridge Centers in the country for supporting re-employment. Their first onsite for the installation of renewable power generation are already in place.

PepsiCo: PepsiCo. Inc. entered the Indian market with the name of PepsiCo India from the year 1989. Within a short time span of 20 years, this company has emerged as one of the fast growing as well as largest beverage and food manufacturer. As per the annual report of the company in the last business year, the net revenue of PepsiCo grew by 33 %. By the year 2020, this food manufacturing company intends to triple their portfolio of enjoyable and wholesome offerings. The expansion of their Good-For-You portfolio is believed to be assisting the company in attaining the competitive advantage of the growing packaged nutrition market in the world, which is presently valued at $ 500 billion.

Ranbaxy Laboratories Limited: Ranbaxy Laboratories Limited, one of the biggest pharmaceutical companies in India, started their business in the country from the year 1961. The company made its public appearance in 1973 though. Headquartered in this nation, this international, research based, integrated pharmaceutical company is the producer of a huge range of affordable cum quality medicines that are trusted by both patients and healthcare professionals all over the world. In the business year 2010, the registered global sales of the company was US $ 1, 868 Mn. Successful development of business forms the key component of their trading strategy. Apart from overseas acquisitions, this company is making a continuous endeavor to enter the new global markets, which have got high potential. For this, they are offering value adding products as well.

Reebok International Limited: This global brand is a famous name in the field of sports as well as lifestyle products. Reebok International Limited, a subsidiary of Adidas AG, is based in U. S. A. (United States of America) started its operation in 1890s. During the last financial year, Adidas's currency neutralized group sales increased by 9 %. Apart from their alliance with CrossFit that is among the largest contemporary fitness movements, in the current year, Reebok's announcement of its partnership with artist, designer and producer Swizz Beatz reflects its long term future growth.

Sony: Sony India is a part of the renowned brand name Sony Corporation, which started their business operation in the year 1946 in Japan. Established in India in November 1994, this company has captured one of the leading positions in the field of consumer electronics goods. By the end of the business year 2010 on 31st March, 2011, the company showed a remarkable increase in the share related to numerous categories. Sony India is planning to invest around INR. 150 crore for the marketing of the activities related to ATL and BTL. As far as Bravia TVs are concerned, they are looking forward to hold their market share of 30 %. In between the last and the current financial year, the number of their outlets in the country increased by 1, 000.

Vodafone: Vodafone Group Plc is an international telecommunication company, which has got it's headquarter based in London in the United Kingdom (U. K.). Earlier known as Vodafone Essar and Hutchison Essar, Vodafone India is among the largest operators of mobile networking in the country. The parent company Hutchison started its business in the year 1992 along with the Max Group, which was its business partner in India. Much later in 2011, Vodafone Group Plc decided to buy out mobile operating business of Essar Group, its partner. The turnover of the Vodafone Group Plc after the completion of the last financial year grew to £ 44, 472 m from £ 41, 017m that was the turnover of the business year 2009.

Tata Motors Limited: The biggest automobile company in India, Tata Motors Limited, is among the leading commercial vehicles manufacturer in the country. They are one of the top 3 passenger vehicle manufacturers. Established in the year 1945, this company, a part of the famous Tata Group, has got its manufacturing units located in different parts of the nation. Some of their well known products of the company are categorized in the following heads:

- Commercial Vehicles
- Defence Security Vehicles
- Homeland Security Vehicles
- Passenger Vehicles

Post completion of the financial year 2010 to 2011, the global sales of the company grew by 24.2 % with sales crossing INR. 1 million.

Profit of MNCs in India:

It is too specify that the companies come and settle in India to earn profit. A company enlarges its jurisdiction of work beyond its native place when they get a wide scope to earn a profit and such is the case of the MNCs that have flourished here. More over India has wide market for different and new goods and services due to the ever increasing population and the varying consumer taste. The government FDI policies have somehow benefited them and drawn their attention too. The restrictive policies that stopped the company's inflow are however withdrawn and the country has shown much interest to bring in foreign investment here.

Besides the foreign directive policies the labour competitive market, market competition and the macro-economic stability are some of the key factors that magnetize the foreign MNCs here. Following are the reasons why multinational companies consider India as a preferred destination for business:

- Huge market potential of the country
- FDI attractiveness
- Labor competitiveness
- Macro-economic stability

4.10 Summary

There is no universally accepted definition of the term, Multinational Corporation. As an ILO report observes, "the essential nature of the multinational enterprises lies in the fact that its managerial headquarters are located in one country while the enterprise carries out operations in a number of other countries as well. MNCs have been spreading and growing across the globe very rapidly. Although the MNCs from the developed countries still dominate the scene, more and more MNCs are emerging from the developing countries It denotes that the activities of multinationals in developing countries are governed for obtaining, maintaining or expanding a foreign market, meeting and overcoming competitive forces in the international bazaar which necessitate the development of foreign bases both at national and regional levels, by taking advantages of low labour costs so on. MNCs help the host countries to increase domestic investment and employment generation, boost exports, transfer technology and accelerate economic growth. The liberalization has paved the way for easy entry and growth of MNCs in India. At the same time a number of Indian firms have been becoming multinational.

4.11 Key Words

- **MNC:** Giant business organization operating in many countries.
- **Product Organization:** Where activitles are divided on the basls of individual product.
- **SBUs:** Strategic Business groups business into strategic units.
- **Matrix Structure:** This type of organizations process the characteristics of functional & project management.

4.12 Self Assessment Test

1. Define 'Multi-National Corporation'? Whatof characteristics or benchmarks of multinational corporations.
2. "Multinational Corporations are the owner of intellectual and physical properties." Discuss it, by giving the element concerning with these corporations.
3. Explain the concept and objective of 'Multinational Corporations'. What are the reasons or causes contributed for the growth of MNCs? Elucidate.
4. What do you mean by Multinational Corporation? Explain the organisational structure of MNCs.
5. Explain the Role and evolution process of Multinational Corporation.
6. Write short notes on the following-
   (i) Product organisation structure
   (ii) Matrix organisation structure

(iii) MNC Organisation
(iv) Relationship between Head Quarters and Subsidiaries

7. "Where Multinational Corporation has more subsidiaries, it must make a permanent relationship in its structure, to be coordinated and controlled the activities, to provide and implemented the information technology." Discuss.

8. How you will define the multinational corporations in India and foreign collaboration?

9. Write shorts notes on following-
   (i) Key points for helping and developing MNCs.
   (ii) Drivers of multinationals.
   (iii) Designing the MNCs.
   (iv Advantages and Disadvantages of Multinational Corporations

10. Explain the control process of Multinational Corporation. Give examples of Top MNCs in India?

4.13 References

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Unit - 5 : International Business Negotiations

Unit Structure:

5.0 Objectives

After studying this unit you will be learn:

- The negotiation process and the role of the government in the process,
- The characteristics affecting negotiation, and
- To use the modern technology in the negotiation process.

5.1 Introduction

Negotiation is the process of discussion by which two or more parties aim to reach a mutually acceptable agreement. The long term goal should be to set up a win-win situation and to bring about a settlement beneficial to all parties concerned. This process, difficult enough when it takes place among people of similar backgrounds, is even more complex in international negotiations because of differences in cultural values, lifestyles, expectations, verbal and nonverbal language, approaches to formal procedures, and problem-solving techniques, The complexity is also heightened when negotiating across borders because of the greater number of stakeholders involved.

The stake holders involved in Cross Cultural Negotiations include :-

- Head quarters employees
- Suppliers
- Home Government
- Home Consumers
- Investors
- Alliance Partners
- Contractors
- All Citizens
- Special Interest Groups
- Host Government
- Distributors

- Expatriate Employees
- Host Local Employees
- Host Consumers

Global managers negotiate with parties in other countries to make specific plans for strategies (exporting, joint ventures, and so forth) and for continuing operations. While the complexities of cross-cultural negotiations among firms around the world present a bigger challenge , managers also sometimes are faced with negotiating with various governmental agencies. Such a situation is illustrated in the case of Enron's Dabhol plant in India where negotiators were faced with years of a shifting political agenda, internal political conflicts between state and national governments, and multiple layers of bureaucratic hurdles, leading to a failed venture.

While initiating the process of negotiations, the first step for managers is to prepare for strategic negotiations. Next the operational details must be negotiated - the staffing of key positions, the sourcing of raw materials or component parts, the repatriating of profits, to name a few. As globalization increases the ability to conduct successfuly cross-cultural negotiations cannot be overemphasized. Failure to negotiate productively will result in lost potential alliances and lost business besides creating confusion and delays.

Effective strategy depends upon management's ability to negotiate productively - a skill widely considered one of the most important in international business. In the global arena, cultural differences produce great difficulties in the negotiation process. Ignorance of native bargaining rituals, more than any other single factor, accounts for unimpressive sales efforts. In preparing for negotiations, it is critical to avoid the assumption that others perceive, judge, think, and reason in the same way when, in fact, they do not because of differential cultural and practical influences. Instead, astute negotiators empathetically enter into the private world or cultural space of their counterparts, while willingly sharing their own view of the situation.

Important differences in the negotiation process from country to country include -

(1) The amount and type of preparation for a negotiation,

(2) The relative emphasis on tasks versus interpersonal relationships,

(3) The reliance on general principles rather than specific issues, and

(4) The number of people present and the extent of their influence. In every instance, managers must familiarize themselves with the cultural back-ground and underlying motivations of the negotiators - and the tactics and procedures they use - to control the process, make progress and therefore maximize company goals.

5.2 Role of Government and Companies in Negotiations

The operating terms of international companies are marked by two important trends. These are :

1) They are influenced by governments of home and host countres.
2) They shift priorities as the strengths of parties change.

The strengths of the parties depend on such factors as the resources that each side has at its disposal, competitives changes, validation by public opinion, and joint efforts with other paties.

1. Negotiations with the Home Country Government:

The Negotiations between businesses and governments influence government enhancements and restrictions that determine companies' operating terms, objectives and strategies. This is shown in the figure below :

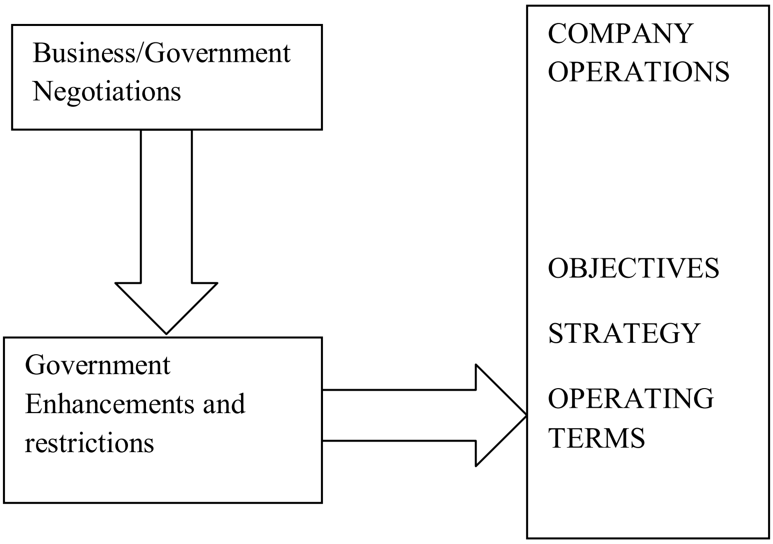

Figure 5.1 : Business-Government Negotiations in International Business

The Home Country has its own needs and objectives which play an important role in International negotiations. Thus the economic objectives of the home country government and the political relations of the home country government with the host country may play an important role in the negotiating process.

2. Negotiations with the Host Country Government:

It is clear that Multinational Enterprises as well as host countries possess mutually useful assets. Thus, an alternative source for acquiring resources will affect the company and country's bargaining strengths.

BARGAINING STRENGTHS FOR COMPANIES	
1.	Large Markets
2.	Technology
3.	Less Business Risk
4.	Marketing Expertise
5.	Political Stability
6.	Ability to export output
7.	Local Product Diversity
8.	Value of FDI

Figure 5.2 : Bargaining Strengths for Countries and Companies

5.3 The Negotiation Process

While in practise these stages are not distinct and tend to overlap, it is useful to study the negotiation process in stages in order to highlight the issues that may emerge at different points in the negotiation in the detail.

1. Preparation:

Preparing for International business negotiations is of vital importance. Negotiations must first of all familiarize themselves with the entire context and background of their counterparts as well as the main subject to be negotiated. Cultural differences, language barriers and environmental variables need to be carefully considered. If one understands the value system, attitudes and expected behaviour of a society it makes negotiating much easier.

The Negotiation Process comprises of five stages :

Stage 1 : Preparation

↓

Stage 2 : Relationship Building

↓

Stage 3 : Exchange of Task Related Information

↓

Stage 4 : Persuasion

↓

Stage 5 : Concession and Agreement

Figure 5.3 : The Negotiation Process

The Preparation stage involves :

(i) Preparing a profile of the other party or parties

(ii) Planning for the actual Negotiation Meeting which requires finding out :-
- The kinds of demands that might be made,
- The composition of the "opposing" team, and
- The relative authority that the members possess.

After this, the managers can gear their negotiation strategy specifically to the other side's firm, allocate roles to different team members, decide on concessions, and prepare an alternative action plan in case a negotiated solution cannot be found.

2. Relationship Building:

Relationship building is the process of getting to know one's contacts in a host country and building mutual trust before embarking on business discussions and transactions. Effective negotiators allow plenty of time in their schedules for such relationship building with baraining partners. This process usually takes the form of social events, tours, and ceremonies, along with much nontask sounding-general, polite conversation and informal communication before meetings - where all parties get to know each another. In some cultures, one patiently waits for the other party to start actual business negotiations, aware that relationship building is, in fact, the first phase of negotiations. It is usually recommended that managers new to such scenarios use an intermediary - someone who already has the trust and respect of the foreign managers and who therefore acts as a "relationship bridge." Relationship building activity sets the tone of the meeting which is called 'posturing'. This phase should result in an atmosphere of confidence and trust.

3. Exchanging task related Information:

In the next stage - exchanging task-related information - each side typically makes a presentation and states its position; a question-and-answer session usually follows, and alternatives are discussed. Negotiators should focus not only on presenting their situation and needs but also on showing an understanding of their opponents' viewpoint. Focusing ont he entire situation confronting each party encourages the negotiators to assess a wider range of alternatives for resoultion, rather than limiting themselves to their preconceived, static positions. To be most effective, negotiators can prepare for meetings by practicing role reversal.

4. Persuasion:

In the next phase of negotiations - persuasion - the hard bargaining starts. Typically, both parties try to persuade the other to accept more of their position and to give up some of thier own. Often, some persuasion has already taken place before hand in social settings and through mutual contacts. Tactics like promises, threats etc are often used. Sometimes less savory tactics like deliberately misleading opponents are used. These are called 'dirty tricks', but it must be remembered that what is considered a 'dirty trick' may vary from culture to culture. The most subtle behaviours in the negotiation process, and often the most difficult to deal with, are usually the nonverbal messages - the use of voice intonation, facial and body expressions, eye contact, dress, and the timing of the discussions. No verbal behaviours are ingrained aspects of culture used by people in their daily lives; they are not specifically changed for the purposes of negotiation. Persuation is the primary purpose underlying all stages of the negotiation process. In particular, persuasion is an integral part of the process of making concessions and arriving at an agreement.

5. Concessions and Agreement:

In the last stage of negotiation - concessions and agreement - tactics vary greatly across cultures. Well-prepared negotiators are aware of various concession strategies and have decided ahead of time what their own concession strategy will be. At the final stage of agreement and contract, cultural values determine how these agreements will be honored.

5.4 Negotiation Styles

Global managers can benefit from studying differences in negotiating behaviours (and the underlying reasons for them), which can help them recognize what is happening in the negotiating process. Look at the comparison between the negotiating styles of Japanese Managers versus their American counterparts. Pierre Casse who has carried out a research has clearly highlighted how both styles are different in their basic premises, asumptions as well as execution.

Table 5.1

Comparison of Negotiation Styles – Japanese, and American

Japanese	North American
Emotional sensitivity highly valued	Emotional sensitivity not highly valued
Hiding of emotions	Dealing straightforwardly or impersonally
Subtle power plays; conciliation	Litigation not so much as conciliation
Loyalty to employer; employer takes care of employees	Lack of commitment to employer; breaking of ties by either if necessary
Face-saving crucial; decisions often on basis of saving someone from embarrassment	Decisions made on a cost-benefit basis; face-saving does not always matter
Decision makers openly influenced by special interests	Decision makers influenced by special interests but often not considered ethical
Not argumentative; quiet when right	Argumentative when right or wrong, but impersonal
What is down in writing must be accurate, valid	Great importance given to documentation as evidential proof
Step-by-step approach to decision making	Methodically organized decision making
Good of group is the ultimate aim	Profit motive or good of individual ultimate aim
Cultivate a good emotional social setting for decision making; got to know decision makers	Decision making impersonal; avoid involvements, conflict of interest.

Source : From Pierre Casse, Training for the Multicultural Manager: A Practical and Cross-Cultural Approach to the Management of People (Washington, D.C.: Society for Intercutural Education, Training, and Research, 1982).

Thus, it is very important for managers to thoroughly study the negotiating style of the managers of the region with whom they are negotiating. Let us examine some examples of the negotiating styles of managers from various parts of the world.

5.4.1 Successful Negotiators Around the World:

Following are selected profiles of what it takes to be a successful negotiator, as perceived by people in their home countries. These are profiles of American, Indian, Arab, Swedish, and Italian negotiators, according to Pierre Casse, and give some insight into what to expect from different negotiators and what they expected from others.

Indian Negotiators:

Indians, says Casse, often follow Gandhi's approach to negotiation, which Gandhi called satyagraha, "firmness in a good cause." This approach combines strength with the love of truth. The successful Indian negotiator thus acts as follows :

- Looks for and says the truth.
- Is not afraid of speaking up and has no fears.
- Exercises self-control ("The weapons of the satyagraha are within him.").
- Seeks solutions that will please all the parties involved ("Satyagraha aims to exalt both sides.")
- Respects the other party ("The opponent must be weaned from error by patience and sympathy. Weaned, not crushed; converted, not annihilated.")
- Neither uses violence nor insults.
- Is ready to change his or her mind and differ with himself or herself at the risk of being seen as inconsistent and unpredictable.
- Puts things into perspective and switches easily from the small picture to the big one.
- Is humble and trusts the opponent.
- Is able to withdraw, use silence, and learn from within.
- Relies on himself or herself, his or her own resources and strengths.
- Appeals to the other party's spiritual identity ("To communicate, the West moves or talks. The East sits, contemplates, suffers.")
- Is tenacious, patient, and persistent.
- Learns from the opponent and avoids the use of secrets.
- Goes beyond logical reasoning and trusts his or her instinct as well as faith.

American Negotiators:

According to Casse, a successful American negotiator acts as follows :

- Knows when to compromise.
- Takes a firm stand at the beginning of the negotiation.
- Refuses to make concessions beforehand.
- Keeps his or her cards close to his or her chest.
- Accepts compromises only when the negotiation is deadlocked.
- Sets up the general principles and delegates the detail work to associates.
- Keeps a maximum of options open before negotiation.
- Operates in good faith.
- Respects the "opponents".
- States his or her position as clearly as possible.
- Knows when he or she wishes a negotiation to move on.

- Is fully briefed about the negotiated issues.
- Has a good sense of timing and is consistent
- Makes the other party reveal his or her position while keeping his or her own position mdeen as long as possible.
- Lets the other negotiator come forward first and looks for the best deal.

Arab Negotiators:

Many Arab negotiators, following Islamic tradition, use mediators to settle disputes. A successful Arab mediator acts in the following way :

- Protects all the parties' honor, self-respect, and dignity.
- Avoids direct confrontations between opponents.
- Is respected and trusted by all.
- Does not put the parties involved in a situation where they have to show weakness or admit defeat.
- Has the necessary prestige to be listened to
- Is creative enough to come up with honorable solutions for all parties.
- Is impartial and can understand the positions of the various parties without leaning toward one or the other.
- Is able to resist any kind of pressure that the opponents could try to exercise on him.
- Uses references to people who are highly respected by the opponents to persuade them to change their minds on some issues ("Do it for the sake of your father.")
- Can keep secrets and in so doing gains the confidence of the negotiating parties.
- Controls his temper and emotions (or loses it when and where necessary)
- Can use conferences as mediating devices.
- Knows that the opponents will have problems in carrying out the decisions made during the negotiation.
- Is able to cope with the Arab disregard for time.
- Understands the impact of Islam on the opponents who believe that they possess the truth, follow the Right Path, and are going to "win" because their cause is just.

Swedish Negotiators:

Swedish negotiators, according to Casse, are :

- Very quiet and thoughtful.
- Punctual (concerned with time)
- Extremely polite.
- Straightforward (they get straight down to business)
- Enger to be productive and efficient.
- Heavy going.
- Down to earth and overcautious.
- Rather flexible.
- Able to and quite good at holding emotions and feelings.
- Slow at reacting to new (unexpected) proposals.
- Informal and familiar.
- Conceited.
- Perfectionist.
- Afraid of confrontations.
- Very private.

Italian Negotiators:

Italians, says Casse, value a negotiator who acts as follows :

- Has a sense of drama (acting is a main part of the culture)
- Does not hide his or her emotions (which are partly sincere and partly feigned)
- Reads facial expressions and gestures very well.
- Has a feeling for history.
- Does not trust anybody.
- Is concerned about the bella figura - the "good impression" - he or she can create among those who watch his or her behavior.
- Believes in the individual's initiatives, not so much in teamwork.
- Is good at being obliging and simpatico at all times.
- Never embraces definite opinions.
- Is able to come up with new ways to immobilize and eventually destroy his or her opponents.
- Handles confrontations of power with subtlety and tact.
- Has a flair for intrigue.
- Knows how to use flattery.
- Can involve other negotiators in complex combinations.

5.5 Managing Negotiations

The successful management of intercultural negotiations requires that a manager go beyond a generalized understanding of the issues and variables involved . She or he must (1) gain specific knowledge of the parties in the upcoming meeting, (2) prepare accordingly to adjust to and control the situation, and (3) be innovative.

Research has shown that a problem-solving approach is essential to successful cross-cultural negotiations, whether abroad or in the home office, although the approach works differently in various countries. This problem-solving approach requires that a negotiator treat everyone with respect, avoid making anyone feel uncomfortable, and not criticize or blame the other parties in a personal way that may make someone feel shame-that is, lose face.

The various factors that managers must analyse while managing negotiations are :-

(a) The position of the other party in regard to their own goals. Are these goals national or corporate ?
(b) The relative importance of completing the task compared to developing interpersonal relationships.
(c) The composition of the negotiating team.
(d) The power allotted to members.
(e) The extent of the team's preparation.
(f) The significance of personal trust in the relationship.
(g) Culture of both the parties involved.

Together these factors will generate -

(i) Negotiating Styles
(ii) Negotiating Behaviour
(iii) Verbal and Non Verbal Behaviour

The figure below shows have the various factors are inter related and linked.

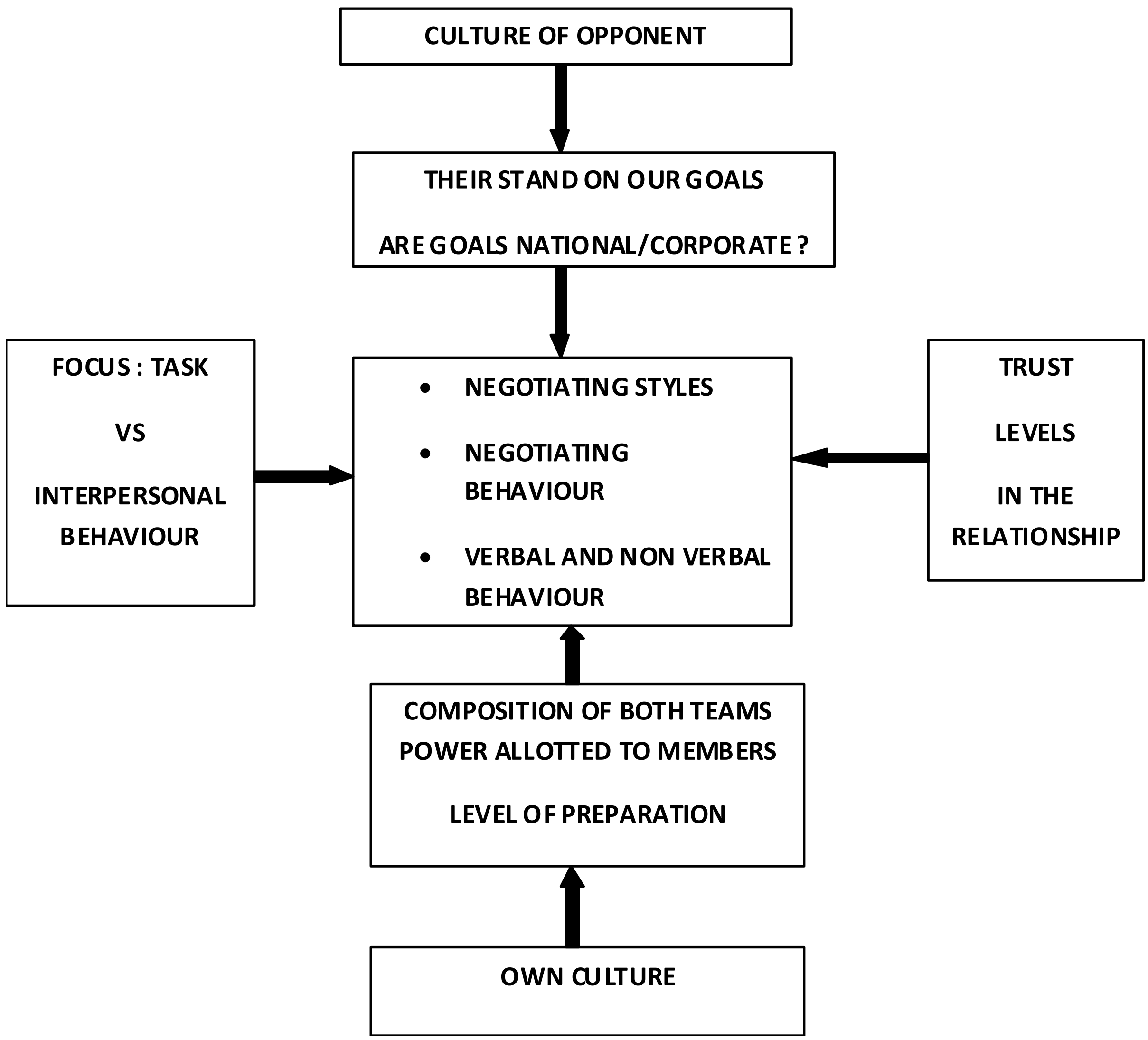

Figure 5.4 : Managing Negotiations

5.5.1 Behavioural Characteristics Affecting Negotiations

Misunderstandings in negotiations may result from differences in :

- Cultures and Nationalities
- Languages
- Professions

Cultural differences that may lead to misunderstandings among negotiators of different nationalities:

- Some negotiators have the power and the inclination to take conclusive decisions, others may be more focussed towards creating a relationship of trust and respect.
- Some take a pragmatic, rational, one-issue-at-a-time view point, others may take a holistic view.
- Some set deadlines or schedules, others may place less importance to punctuality and schedule.

• Language Barriers often cause confusion:

Language Barriers may include :

- The negotiations may not speak the same language.
- It is often difficult to find words in another language that exactly expresses the intented meaning of the original statement.
- In may cultures translators and interpretors are acceptable, while in others they may not be.
- Sometimes in the same language, the word may have different meanings in different countries.
- Non verbal expressions may also have different meanings in different cultures increasing the complexity of understanding speech of a person belonging to a different culture.

• Professional Conflict:

- Government and business negotiators may begin with mutual mistrust due to historic animosity or differences in their professional status.
- The objectives of Businessmen are very different from those of Governments, so while businessmen may rely on economic and market data, the Government may not appreciate or accept it. The businessmen may also fail to appreciate the considerations of the Government.

5.5.2 Creating a Culturally Responsive Startegy for Negotiations

Keeping in mind two important dimensions, negotiators for International Business can formulate a culturally responsive strategy. These two important dimensions are :

(i) Negotiator's familiarity with the counter part's culture.

(ii) Counter part's familiarity with the negotiator's culture.

At each level of familiarity, a negotiator can consider feasible the strategies designated at that level and any lower level. Thus, if both parties are totally unfamiliar with each other's culture it will be better to employ an agent or mediator to negotiate (Level 3) but if both parties are externely familiar with each others culture they will be able to create a harmonious approach by improvising and imbibing both cultures. (Level 5)

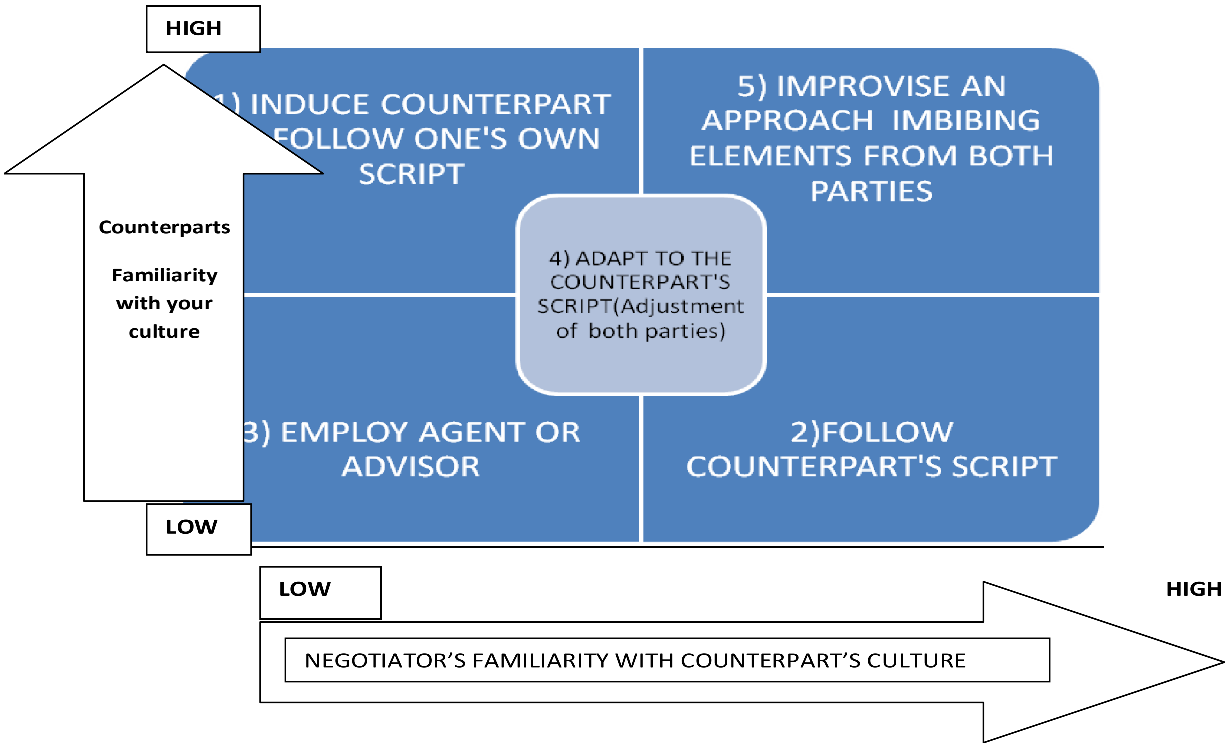

Figure 5.5 : Culturally Responsive Stratgies and their Feasibility

5.6 Using Modern Technology for Negotiations

Using the Web to Support Negotiations:

Modern technology can provide support for the negotiating process, though it can't take the place of the essential face-to-face ingredient in many instances. A growing component for electronic commerce is the development of applications to support the negotiation of contracts and resolution of disputes. As Web applications develop, they may provide support for various phases and dimensions, such as : Multiple issue, multiple party business transactions of a buy-sell nature, international dispute resolution (business disputes, political disputes), internal company negotiations and communications, etc.

Negotiation support systems (NSS) can provide support for the negotiation process in the following ways:

- Increasing the likelihood that an agreement is reached when a zone of agreement exists (solutions that both parties would accept)
- Decreasing the direct and indirect costs of negotiations, such as costs caused by time delays (strikes, violence), and attorneys' fees among others.
- Maximizing the chances for optimal outcomes.

One Web-based support system, developed at Carleton University in Ottawa, Candada- called Inspire - provides applications for preparing and conducting negotiations and for renegotiating options after a settlement. Users can specify preferences and assess offers; the site also has graphical displays of the negotiation process.

E-Negotiation:

Increasingly, the negotiation process is carried out through e-commerce, as more and more e-marketplaces replace middlemen in trading around the world. One example is Samsung's e-Chaebol 'Chaebol' is a Korean word that refers to a family-run conglomerate. The trading arm of Samsung has used the Internet to transform its role as a middleman into a global e-market player. Transactions through trading auctions reduce the need for personal negotiations.

5.7 Summary

Negotion is the process of discussion by which two or more parties try to reach a mutually acceptable agreement. Cross Cultural negotiations involve several stakeholders which increases the complexity of negotiating accross international borders. Negiotiating differs from country to country therefore managers must understand these differences if they have to conduct successful international business negotiations. The operating terms of international companies are also influenced by the governments of home and host companies. They are also likely to be greatly impacted by the changes in the strengths of the parties involved.

International business managers must understand the negotiating style that they must adopt as well as follow a specific process for carrying out negotiations. They also must study the negotiating styles of successful negotiators from accross the world and the behavioural factors involved in order to Manage Negotiations and create a culturally responsive strategy for Negotiations. Now-a-days, technology is being increasingly used for negotiations so it must be understood and adopted.

5.8 Key Words

- **Negotiations :** The process of discussion by which two or more parties aim to reach a mutually acceptable agreement.
- **Cross Cultural** : That which involves the businesses and/or governments of two or more than two countries.
- **Stakeholders** : Individuals, groups, governments or countries who are in some way linked to the stiuation and whose outcomes depend upon the outcomes of the situation.
- **Bargaining Strength** : The strength of a party (business or government) to get the other party (business or goverment) to agree to its terms and conditions. The bargaining strength could be due to factors like access to or availability of resources etc.
- **Concessions Strategy** : A well prepared list of things which the negotiator is willing to compromise upon or forgo. The concession strategy will be prepared in advance but will be kept highly confidential by the Negotiator.
- **Negotiating Tactics** : These may refer to promises, threats etc which may be made to make the other party agree to what one wants it to do.
- **Negotiating Style** : This refers to the behaviour of a negotiator belonging of a specific regional area, country or school of thought during the process of negotiations.
- **Behavioural Characteristics affecting Negotiations** : The variables of behaviour which may affect negotiations positively or negetively.
- **Negotiation Support System** : or NSS is a software which can provide support to negatiation process.
- **E-negotiation** : The process of carrying out negotiations through e-commerce and thereby reducing the problems associated with face to face negotiations.

5.9 Self Assessment Test

1 'Negotiations in International Business are complex and need to be skillfully conducted'? Discuss.

2 Discuss the role of Government and the company in Negotiations.

3 Explain the Negotiation Process.

4 What is the importance of understanding negotiating styles for the International Business Manager?

5 How can negotiations be managed successfully ?

6 What are the various Behavioural Characteristics affecting Negotiations ?

7 Can Modern Technology be used to make Negotiations more effective ? How ?

5.10 References

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Unit - 6 : International Trade Policies

Unit Structure:

6.0 Objectives

After studying this chapter, you should be able to —

- Understand the need for international trade policy
- Analyze the instruments of trade policy
- Understand trade in merchandise and the instruments of international economic relations
- Explain the impact of diplomacy and foreign policy on international business
- Understand the impact of international law on international business.

6.1 Introduction

International trade has been growing faster than world output indicating that the international market is expanding faster than the domestic markets. There are indeed many Indian firms too whose foreign business is growing faster than the domestic business. Business, in fact, is increasingly becoming international or global in its competitive environment, orientation, content and strategic intent.

Managing any business strategically needs an understanding of the business policies. But in case of global companies, a greater understanding of trade policies is essential. International trade policies deal with the policies of the national governments relating to exports of various goods and services to various countries either on equal terms and conditions or on discriminatory terms and conditions. For example, Russia's trade policy indicates that it allows Indian imports, though the price and quality are unfavourable compared to those of other countries. Similarly, China imports goods from Pakistan on preferential terms like fewer rates of tariffs etc.

Trade policies also aim a protecting the domestic industry from the competition of advanced countries through imposing quotas. Trade policies of some countries aim at building competencies of the domestic companies by providing subsidies. Thus, the countries announce trade policies from time to time. An understanding of these policies enables the MNCs to formulate their strategies regarding entry and conduct of business in various countries.

Government announces their trade policies with regard to. the following from time to time. These are also called the instruments of trade policy. They are:

- Tariffs
- Subsidies
- Import Quotas
- Voluntary Export Restraints
- Local Content Requirements and
- Administrative Policies.

International relations among the governments of various countries directly and indirectly influence the size and direction of international business. According to Krishnaveni, "international relations are the state of peaceful co-existence that prevails among the nations of the world, which is governed by various factors, some of which are power politics, economic interdependence among states and social patterns that set in, due to various happenings in the course of the passing years." International relations are governed by the foreign policies of the governments in terms of social, technological, economic and political. The foreign economic policies of the government greatly influence the international business dimensions. Now, we study the international economic relations.

6.2 Merchandise Trade

The combined trade in goods ($15.2 trillion) and services ($3.7 trillion) was about $18.9 trillion in 2010. The ratio of goods and services in the total global trade remained more or less the same since 1990 at 4:1 (i.e., goods account for about four-fifths and services one-fifth of the total trade).1 The average annual growth rate of both goods and services trade for a long time has been about double the output growth rate.

TABLE 6.1
WORLD EXPORTS OF MERCHANDISE AND COMMERCIAL SERVICES (BILLION DOLLARS AND ANNUAL PERCENTAGE CHANGE)

2010 (in $ billion)		Annual Percentage Change			
	2010	2 008	2009	2010	2005 -10
Merchandise	15,238	15	-22	22	8
Commercial services	3,665	13	-12	8	8
Transport	783	16	-23	14	7
Travel	936	10	-9	8	6
Other commercial services	1,945	13	-8	6	9

Source: WTO, World Trade Report, 2011

Growth of Merchandise Trade

Table 6 .2 shows the growth of world merchandise exports. The table indicates that during 1950-60, the value of world exports more than doubled. In the next decade, it increased nearly 2% times. During the 1970s, the value of the world exports increased by about 5% times. Worldwide inflation, particularly the successive hikes in oil prices, significantly contributed to this unprecedented sharp increase in the value of world exports. During 1980-90, the value of world exports increased by 80 per cent. Between 1990 and

2000, it increased by over 90 per cent and about 140 per cent during 2000-2010. In fact, exports of developing countries have been increasing faster than those of the developed.

Table 6.2 :Growth of World Merchandise Exports

Year	Value of Merchandise Exports(in billions of US $)
1950	53
1960	113
1970	280
1980	1,846
1990	3,311
2000	6,350
2008	15,775
2009	12,147
2010	15,238

Sources: International Trade Statistics and WTO *World Trade Report, 2009, 2010* and *2011.*

Historically, trade growth consistently outpaced overall economic growth for at least 250 years, except for a comparatively brief period from 1913 to 1950 characterized by heavy protectionism which was almost a by-product of the two World Wars. Between 1720 and 1913, trade growth was about one-and-a-half times the GDP growth. Slow GDP growth between 1913 and 1950 — the period with the lowest average economic growth rate since 1820 — was accompanied by even slower trade growth, as war and protectionism undermined international trade. This period was also plagued by the great depression. 2009 witnessed a dramatic decline in world trade — about 12 per cent in volume terms and about 23 per cent in value terms thanks in large part to falling prices for oil and other primary products (See Figure 6.1).

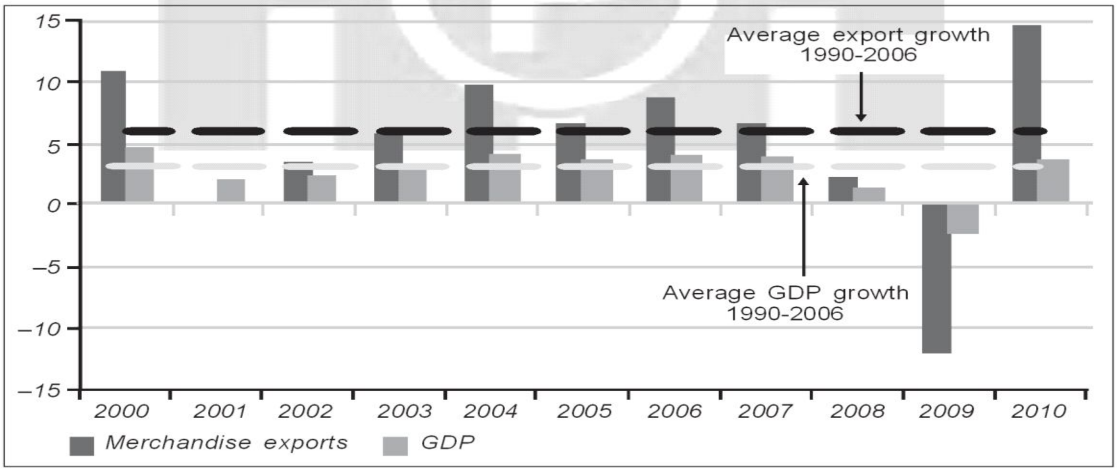

Figure 6.1: Growth in volume of world merchandise trade and GDP, 2000-10 (Annual percentage change)
Source: Adopted from WTO, World Trade Report, 2011

6.3 International Trade Policies

6.3.1 Tariffs

Tariffs refer to the tax imposed on imports. Tariffs are of two types, *viz.,* specific tariffs and advalorem tariffs. Specific tariffs are levied as a fixed charge for each unit of the product imported. *For example,* a tariff of Rs.l, 000 on each TV imported.

The tariff levied as a proportion of the value of the imported goods is called *'ad valorem'* tariff. *For* *example,* imposition of 30 per cent tax on the value of computers imported. A 10% advalorem duty is imposed in addition to the existing specific duty on all slabs of cigarettes other than filter and non filter cigarette of length not exceeding 65 mm. Excise duty on Lithium ion batteries packs for supply to electric vehicle/Hybrid vehicle manufacturers is reduced from 10% to 6% up to 31st March, 2013. Basic customs duty is increased on gold ores and concentrates for use in the manufacture of gold from 1% to 2%. Export duty on "chromium ores and concentrates, all sorts" is enhanced from Rs. 3000 per tonne to 30% ad valorem. The purpose of tariffs is to protect the domestic industry by increasing the cost of imported goods. Government of India imposed tariffs to protect domestic automobile industry, sugar industry, cement industry and steel industry.

Tariff Rates and Their Adjustments

According to WTO statistics, India's simple average tariff for most-favored nations (MFN) was 13.0% in 2008. The simple average MFN tariff was 32.2% for agricultural products and 10.1% for non-agricultural products. On July 6, 2009, India's Ministry of Finance promulgated *Budget 2009-2010,* as the basis for annual policy. The budget not only adjusted tariff, excise and services tax, but put forward a package of trade promotion measures. Tariff adjustments mainly include lowering import duty on certain medical supplies, capital goods, renewable energy, electronics and textiles.

Medical Equipment: Duty on 10 kinds of specified life-saving medicine / vaccines and their bulk drugs is reduced from 10% to 5%, with no additional duty (by way of excise duty exemption); Duty on the specified cardiac treatment equipment, namely, artificial heart and PDA / ASD occlusion device, is reduced from 7.5% to 5%, with no additional duty (by way of excise duty exemption).

Electronics Hardware: Duty on LCD panels for manufacture of LCD televisions is reduced from 10% to 5%; Exemption from 4% special additional duty for manufacturing parts of mobile phones and accessories is extended for another year, up to June 7, 2010.

Renewable Energy: Duty on permanent magnets for PM synchronous generator above 500 KW used in wind operated electricity generators is reduced from 7.5% to 5%; on bio-diesel from 7.5% to 2.5%; Capital goods: 5% concessional customs duty on specified machinery for coffee, tea and rubber plantations is extended for another year, up to July 6, 2010; Duty on mechanical coffee harvester is reduced from 7.5% to 5%, and its additional duty is reduced from 8% to nil; Textiles: Customs duty on cotton waste and wool waste is reduced from 15% to 10%. Increasing duty on certain metals (gold bars, silver); removing the duty exemption on TV set- top box, imposing 5% import duty.

The following parties gain from the tariffs:

- Government of the importing country: Government of the importing country gets the revenue in the form import duties.
- Industry of the importing country: The products of the importing country would find market as the cost of imported goods is higher than that of domestic goods.
- Jobs in the domestic country are saved.
- Business for the ancillary industry, servicing, market intermediation etc. is also protected.

However, the following parties are adversely affected by the tariffs

- Consumers of the domestic country lose as they have to pay a higher price. Thus, the customers pay for the inefficiency of the domestic industry.
- The industry of the exporting country loses the demand for its product, sales and profit.

Ultimately, tariffs enhance the efficiency of some countries and curtail the growth of the most efficient countries. Thus, tariffs reduce the efficiency of world economies. This process results in inefficient utilisation of all kinds of resources.

6.3.2 Subsidies

In order to encourage domestic production or to protect the domestic producer from the foreign competitors, government pays to a domestic producer by reducing operations cost Such payments arc called subsidies. Subsidies are in different forms. They are: cash grants, loans and advances at low rates of interest, tax holidays, and government procurement of output at a higher rate, equity participation and supply of inputs at lower prices.

Subsidies help the domestic producers in the following ways:

- Acquire the character of a low cost producer and have all the advantages of a low cost producer like high profit margin or fixing the price at lower level.
- Compete with a foreign producer in the domestic market.
- Enter the foreign markets.

Subsidies in advanced countries:

The government of not only developing countries but also advanced countries provides subsidies. *Similarly,* subsidies are provided by the government not only to the agricultural sector, but also to the industrial sector. Subsidies provided by different countries are as follows:

- Most industrialized countries provided subsidy between 2 to 3.0 per cent of their industrial output during 2000s.
- The average rate of subsidy provided in the USA is 0.5 per cent of the output, it is one per cent in Japan, 2 per cent in the UK and Germany, 6 to 7 per cent in Sweden and Ireland. These subsidies are only in the form of cash grant.
- Subsidies including different forms are 2 per cent in the UK, 14.6 per cent in Greece during 2000s.
- Subsidies in Italy arc 3 times more than that of the UK, two times more than that of Germany and 1.5 times more than that of France in 2006.(Table 10.2)

Advantages and disadvantages of subsidies:

As stated earlier, subsidies enhance the international competitiveness of the domestic industry. Therefore, the domestic business, industry and advocates of strategic international trade favour subsidies. Subsidies, in turn, help the firms to have large scale economies and advantages of low cost production. In addition, these advantaged firms can enter the foreign markets before the firms of other countries and can this also have the advantages of the first mover. Dr. Reddy's I.ab got the advantages of low-cost producer and the first mover advantages in Asian and African countries. *Similarly,* US subsidies helped Boeing to have the first mover advantages. The first mover advantages, in their turn, bring the advantages of employment and tax gains to the domestic country.

Subsidies are paid by the government by taxing the individuals. Thus, subsidies are a national cost. Therefore, subsidies should produce national benefit more than the national cost. Otherwise, subsidies are a national waste. In fact, subsidies do not enhance international competitiveness of the domestic companies.

In such cases, subsidies protect the inefficiency and lethargy of the domestic firms. Hence, the World Trade Organisation proposed phased withdrawal of subsidies.

Subsidies in developing countries:

In fact, the Indian government has already started withdrawing the subsidies on fertilisers, pesticides, prices of agricultural output, output of small-scale industries etc. Withdrawal of these subsidies with regard to agricultural sector and small-scale industrial sector led to the closure of certain small-scale industrial units. It led to increased losses to the Indian farmers and also suicide deaths of Indian farmers owing to indebtedness.

Indian experience shows that subsidies in developing countries basically reduce losses and provide insurance against crop failure, market fluctuations, shifts in customer tastes and technology changes. Thus, it is viewed that subsidies in developing countries are aimed at providing sustainability for the agriculture sector and small-scale industrial sector in order o provide employment and livelihood for masses.

As such, the farmers, small-scale industrialists, unemployed and advocates of subsidies criticize the WTO policy of phasing out subsidies.

6.3.3 Export Quotas

Quantitative restrictions which take the form of quotas is a very important traditional means of restricting imports and exports. The impact of quotas is drastic in comparison with tariffs.

There are import quotas and export quotas.

Export Quotas: A quota on the export of a product room a country may be imposed if the government feels that exports in excess of that will affect interest of the domestic consumers. Sometimes an export quota is the result of an international commodity agreement.

6.3.4 Import Quota

Import quota is a direct restriction on the quantity of goods which are imported into a country. These restrictions are imposed by issuing import licenses to certain firms and individuals to import a certain quantity of the goods. India had quotas of imports of various goods like cars, motor cycles, milk etc., up to 31st March 2001. Import quotas provide protection to the domestic firms from the foreign competitors.

Important types of import quotas are described below:

1. **Tariff Quota:** A tariff quota combines the features of the tariff as well as of the quota. Under a tariff quota, the imports of a commodity up to a specified volume are allowed duty free or at a special low rate; but any imports in excess of this limit are subject to duty or a higher rate of duty.

2. **Unilateral Quota:** in a unilateral quota, a country unilaterally fixes a ceiling on the quantity of the import of a particular commodity.

3. **Bilateral Quota:** a bilateral quota results from negotiation between the importing country and a particular supplier country, or between the importing country and export groups within the supplier country.

4. **Mixing Quota:** under the mixing quota, the producers are oblized to utilize domestic raw materials up to a certain proportion in the production of a finished product.

6.3.4 Voluntary Export Restraints

VERs is bilateral arrangements instituted to restrain the rapid growth of exports of specific manufactured goods. The United States and the European community have, thus regulated the imports of several products. Under the VERs, te exporting country voluntarily restrains the export of the specified product in order to either help the other country to reduce its trade deficit or to protect domestic industry (of the importing country).

A voluntary export restraint is the opposite form of import quotas. A voluntary export restraint is a quota on exports of the domestic firm imposed by the exporting country. Exporting country imposes such restriction, mostly at the request of the importing country. *For example,* Japanese automobile exporters had such restraint in 1981 due to the request of the US government. Foreign exporters mostly accept for the voluntary export restraint as its violation leads to imposition of import tariffs, import quotas etc.. Import quotas and voluntary export restraints help the domestic firms by providing protection from the foreign competitors. These enhance the prices of import goods and make the domestic goods cheap.

6.3.5 Local Content Requirement

Local content requirement is a condition that requires some specific fraction of a product imported be produced domestically. The requirement may be in physical terms (50% of the components should be from the domestic country) or in value terms (50% of the value of the product should be produced domestically).

Most of the developing countries insist on the local content requirements in order to shift at least certain part of manufacturing base in their country. This helps the country to enhance the employment opportunities, utilisation of local resources and economic activities. This factor protects the domestic producer as in case of quotas.

6.3.6 Administrative Policies

Administrative policies are bureaucratic rules and procedures which are formulated to make it difficult for imports to enter the country. Formal trade barriers like tariffs and quotas are the lowest in Japan. Japan mostly uses the administrative policies. It is a quite contradicting issue to-study trade policy in these days of globalization. Some argue that government should intervene in formulating trade policies while others reject it. As such, we now analyze the argument for government intervention in formulating trade policies.

6.4 Government Intervention in Trade Policies

Traditionally, it had been voiced that government is the custodian of the nation including industry and business. Consequently, business has become inefficient due to heavy protection provided by the government. The other school of thought is that the business can run efficiently and creatively in order to give more value for the customer's money, when it is free from government intervention and protection.

Politicians argue for government intervention from the point of view of national security, protecting industries, protecting jobs etc.

1. National Security: Strategic industries from the point of view of national security should be run by the government. These industries include: defence, aerospace, electronics, semiconductors, posts, railways and the like. Government runs these industries even in earlier market economies like the USA and Japan. Even after liberalisation and globalisation of Indian economy, Government in India reserved eight strategic industries (from the national security point of view) for exclusive public sector operation.

2. Protecting Industries: One of the major objectives of the government is to protect the domestic industry from the foreign competitors. This can be done only if the government runs the industry as the foreign competitors easily kill the private industry or business. [his is clearly evident from the Indian experience. Most of the sick small scale industrial units have become mortal and the healthy small and medium industries have become sick after the entry of foreign industries. This is more so, after the entry of cheap products from China and East Asian countries tlike Thailand, South Korea and Malaysia) into the Indian market. Therefore, politicians argue that government should interfere in the business.

3. Protecting Jobs: The economic liberalisation in India led to the closure of many small industries, downsizing of the large industries, outsourcing of employees, privatisation (or disinvestment) of public sector units etc. This in turn, reduced the number of jobs in the country. This is true with all other countries which liberalised and globalised their economies. Hence, politicians argue that the government should interfere in business in order to protect the basic right of the people, *i.e.,* right for job.

4. Retaliation: The foreign businesses need to be threatened and should be dealt with a *tough approach.* Only governments can deal with a *tough approach and attitude* with the foreign businesses. Governments can do this due to the power to take tough decisions and availability of machinery to implement the decisions. Otherwise, the foreign businesses control the domestic business firms. As such, the politicians argue for the government in business as under:

Having discussed the political arguments, we shall discuss the economic arguments for government intervention in the business.

- Economic arguments for government intervention
- Economic arguments include infant industry argument and strategic trade policy.
- Infant Industry Argument: When the industry is in the infant stage of its life cycle, it needs protection from the foreign competitors. In fact, Indian government protected our industry during 1947 to 1990. Private industrialists cannot invest heavily during the infant stage. Therefore, government should interfere in business to provide capital and infrastructural facilities.
- Strategic Trade Policy: According to the strategic trade policy, the government intervention is essential in the form of subsidies. The government should provide subsidies to certain domestic firms which have competitive advantage. These firms with low cost advantage will move to the foreign markets and get the first mover advantages. Thus, government should use subsidies to support promising firms which are dynamic in emerging markets.
- Foreign competing firms may create entry barriers to the domestic tirms even in the home country. Then the government intervention is necessary to provide the entry to the domestic firms in the domestic market. The US government played this role to provide the entry to the domestic firms when Japanese automobile firms created entry barriers.
- Thus these arguments suggest a rationale for government intervention in international business. Government role is essential when foreign firms create entry barriers by having the first mover advantages (market provided to Airbus when Boeing created entry barriers).
- However, it is criticized that the strategic trade policy looks good in theory, but it may be unworkable in practice. They therefore, suggest global trading system.
- Global trading system

Despite the arguments for protectionism, there are strong arguments for free global trade In fact, the protectionism and the government intervention practically led to the inefficiency of both public and private sector industrial units. Consequently, the customers in the protected economies had to pay high price for low quality products. And sometimes, the customers were denied of the supply of the product due to regulated production and distribution. These realities suggest a case for free global trade. Adam Smith and David Ricardo long back advocated free trade.

David Ricardo as a Member of Parliament could influence the British Government to go in for free trade in 1846. Added to this, the crop failure in Britain during the same period made the government opt for free trade. But the great depression of 1929- 33 reversed the position. The US and the UK governments followed protectionism consequent upon the depression in order the protect domestic industry and jobs.

Implications for Business: Why should international business managers care, for the political factors? What are the implications of these political factors for international business? The answer is that, trade barriers have direct impact on a company's strategy.

Trade Barriers Company's Strategy:

It would be better for the international firms to produce and market the products in foreign markets other than those specified for national security. International firms should have the strategy of producing certain components or parts of the products in the host country and export the products to other foreign countries. The international firm should have the strategy of locating the manufacturing facilities in the host country rather than exporting the products. hits strategy helps the foreign company from avoiding the effect of tariffs. This strategy also help the foreign company to avoid the voluntary export restraints.

Japanese automobile firms employed this strategy by locating their manufacturing facilities in the USA. This strategy helped them to compete the US firms on equal footing.

Location of manufacturing facilities in the host country even when trade barriers do not exist reduces the threat of imposing trade barriers in future. These strategies, though they enhance costs, help to have competitive advantages over other foreign companies and also the firms of the host country. As indicated earlier, formulation of trade policies by the government is mostly influenced by its relations with other countries.

6.5 International Trade Relations

International relations study the factors and activities affecting the external policies of the governments. Governments of various countries maintain a balance between their national interests and international responsibilities. Interaction among countries varies from complete cooperation or collaboration to conflict.

Trade among nations had developed over the period. Later, the nations have started cooperating among themselves by establishing various economic organizations like banks, industries, business firms in various countries. These developments over the period led to the formulation of various economic policies like tariffs policy, international cartels, intergovernmental commodity agreements, dumping and pre-emptive buying, quotas and licences, state trading and subsidies etc.

1. **Tariff Policy**: Tax or duty imposed on imports and exports is called tariff. Tariffs are levied for protecting domestic industry from the competition of foreign companies and/or for earning revenue to the government. Tariff policy deals with the purpose of tax rates and structure of tax etc. Rates and structure vary from country to country and from product to product. Tariffs protect domestic industry and also enhance inefficiency. They increase the prices of products or goods. The trend of protectionism has continued since World War II. Formation of trading blocks or regional groupings

reduced the trend of tariffs. Further, the formation of General Agreement on Tariffs and Trade (GATT) and subsequent establishment of the World Trade Organisation are trends towards the elimination of tariffs.

2. **International Cartels:** Companies carrying out the same business join together in order to avoid competition among themselves in order to exert monopolistic influence overprice, quality and quantity of production. Cartels were prominent in Germany in the 19th century. International cartels are agreements among companies or countries, carrying out the same business but located in different countries in order to exert monopolistic competition. Examples of international cartels are: Organisation of Petroleum Exporting Countries and International Air Transport Association. (See Box 10.1)

3. **International Commodity Agreements:** Countries producing the same products and exporting to the same countries enter into an agreement in order to avoid competition among themselves. Such Agreements are referred to as 'International commodity agreements.' International commodity agreements use different techniques like buffer stock agreements and price controls, in order to attain their objectives.

4. **Dumping:** Dumping means selling the products at a price less than the on going price in the market or less than the cost of production. Dumping is used to sell the excess production or to earn foreign exchange. Germans and Japanese used dumping during World War II. Presently China is dumping its products in Indian market. The importing countries impose anti-dumping duties in order to protect the domestic industry from dumping.

5. **Pre-emptive Buying:** During the war crisis countries buy the goods from the neutral countries in order to depriving the enemy from having the products needed by them.

6. **Quotas and Licenses:** Quotas are quantitative controls imposed by the importing country on import of goods. Quantitative restnctions or quotas are to protect the domestic industry from the foreign competitors. However, quotas make the domestic industry inefficient.

7. **State Trading:** State trading is the trading (exports and imports) performed by the government. b' Government performs the trading in a limited number of goods and services.

8. **Embargoes:** Embargoes may prohibit the shipment of all goods to a particular country or to a group of countries.

9. **Boycott:** Boycott is the opposite of embargo and it stops the imports from a country or a group of countries.

6.6 International Laws and Business Firms

Muthiah defines international law as "law applicable to relations between states, but in modern times, individuals are becoming more and more subject to international law such that the law of nations is applicable to individuals in their relations with the states and even to certain interrelationship of individuals." International law aims at maintaining orderly system of international relations. it also aims at securing justice for human beings. It deals with the rights, duties and interests of the nations. It also deals with the rules and regulations governing the business of MNCs.

1. Material Sources of International Law: The material sources of international law include:

- International Customer
- Treaties include law-making treaties and treaty contracts.

- Decisions of judicial or arbitral tribunals.
- Juristic works.
- Decisions of the organs of international institutions and international conferences.

2. International Disputes: Disputes between states, between states and individuals, corporate bodies and non-state entities are termed as international disputes. The methods of settlement of international disputes include: peaceful and amicable means of settlement and forcible or coercive means of settlement.

Peaceful and amicable means of settlement takes the following forms:

- Arbitration
- Judicial settlement
- Negotiation, good offices, mediation, conciliation or inquiry
- Settlement under the auspices of UNO.

Means of forcible or coercive settlement include:

- War and non-war armed action
- Retortion (Retaliation against discourteous acts of another state)
- Reprisals (Seizure of property or persons, boycott of goods of a state)
- Pacific Blockade (blockade of a port of another state in retaliation during the peace times)
- Intervention.

3. Impact of Treaties on Business: As indicated earlier international law Consists of treaties, conventions and agreements. International treaties and agreements invariably affect the international business. Friendship, Commerce and Navigation (FCN) treaties are quite common and they include commercial relations among nations. Treaties and agreements relating to tax rates, quotas, tariffs etc. influence the international business directly. Treaties create obligation on the part of the states and private business houses of the member countries to the treaty.

4. Private international law: Law applicable to private parties or private corporate bodies is called private law. Private law is concerned with the rights, duties, obligations and disputes between/among persons and corporate bodies of different countries. Private law is concerned with selecting the law applicable to the parties of the transactions, choice of jurisdiction (place/country) and enforcement of judgement.

5. **International Court of Justice:** International Court of Justice was established in 1945, with headquarters situated at the Hague, Netherlands. Parties to this court are restricted to the states.

6 International Chamber of Commerce: International Chamber of Commerce is a worldwide organisation. Its members are from all business sectors and from different countries. The objectives of International Chamber of Commerce include:

- To represent business, intergovernmental institutions and conferences.
- To standardise, codify and harmonise international business practice.
- To provide services to its members and international business community.
- To provide link between countries with different economic systems and social structures.

7 Country groups: Different countries form into groups in order to achieve certain objectives. Important among them are: G-8, G-20, G-77 and G-l5. Now, we shall discuss these in detail.

1. **G-8 (Group-8):** The G-8's roots lie in the oil crisis and global economic recession of the early 1970s. In 1973, these challenges prompted the US to form the Library Group - an informal gathering of senior financial officials from Europe, Japan and the US. At the instigation of the French, the 1975 meeting drew in heads of government. The delegates agreed to meet annually. The six nations

involved became known as the G-6, and later the G-7 and G-8 after the respective entries of Canada (1976) and Russia (1998). With no headquarters, budget or permanent staff, the Group of Eight is an informal but exclusive body whose members set out to tackle global challenges through discussion and action.

The purposes of G-8 are:

- To deal with the major economic and political issues of their countries and international community.
- To deal with macroeconomic management, international business and relations with developing countries.
- To deal with the non-economic issues like employment, information highway, transnational issues like environment, crime and drugs, human rights, regional security etc.

Organization:

The presidency of the G-8 rotates between the group's member nations on an annual basis. The country holding the presidency in a given year is also responsible for hosting the annual summit, and for handling the security arrangements. The leaders of these countries meet face-to-face at an annual summit that has become a focus of media attention and protest action. Initially set up as a forum for economic and trade matters, politics crept onto the G-7 agenda in the late l970s. Issues under consideration at recent summits have included helping the developing world, global security, Middle East peace and Iraq reconstruction. G-8 members can agree on policies and can set objectives, but compliance with these is entirely voluntary. The G-8 has clout in other world bodies by virtue of the economic and political muscle of its members.

The workings of the G-8 are a far cry from the "fireside chats" of the Library Group in the 1970s. Holed up behind fortress-like security, the delegates are accompanied by an army of officials. Elaborate preparations are made for their meetings, statements and photo-calls. Nevertheless, G-8 leaders strive to keep at least some of their encounters free from bureaucracy and ceremony. On the second day of their summit the leaders gather for an informal retreat, where they can talk without being encumbered by officials qr the media. The European Union is represented at the G-8 by the president of the European Commission and by the leader of the country that holds the EU presidency. The EU does not take part in G-8 political discussions. G8 Countries conduct their, summits every year to discuss the world challenges and assist the countries facing the challenges.

Leaders expressed deep concern about the tragic humanitarian crisis in Sudan and urged the Government of Sudan and rebel groups to engage in a political peace process, provide safe and unhindered humanitarian access to those affected by the crisis and accept folly the United Nations! African Union hybrid peacekeeping force. Leaders took the opportunity of their annual statement on non-proliferation to reaffirm their common resoive to counter proliferation of weapons of mass destruction (WMD). G8 members underlined their commitment to international efforts In this area, articularly in the face of challenges from countries such as Iran and North Korea. The statement calls on all States to abide by international nonproliferation treaties and signals the G8's willingness to help countries that require assistance to meet treaty obligations.

GB Leaders recommitted to the GB-Africa partnership, noting that while much more remains to be done, progress is being made on the priorities outlined in the New Partnership for Africa's Development. The GB agreed to focus their assistance on those countries that make a political commitment to good governance, democracy and socio-economic development. The GB Leaders reaffirmed their commitments on international assistance to Africa, and emphasized the need to address priorities central to Africa's future: strengthening good governance and institutional capacities; fostering investment and sustainable growth; promoting peace and security; and improving health systems and fighting HIV/AIDS, tuberculosis, and malaria.

In highlighting ongoing efforts to combat terrorism, leaders emphasized the importance of compliance with international law and human rights and stressed the protection of freedom of expression ad religion as an important balance to co-operative action again terrorism. G8 Leaders agreed to promote a consolidated set of internationally recognized Corporate Social Responsibility (CSR) guidelines and principles for extractive sector industry (mining, oil and gas) that will help clarify expectations of investors in developing countries.

The G8 summits during the 21st century have inspired widespread debates, protests and demonstrations; and the two- or three-day event becomes more than the sum of its parts, elevating the participants, the issues and the venue as focal points for activist pressure. The current form of the G8 is being evaluated. Some reports attribute resistance to the relatively smaller powers such as Canada and Japan, who are said to perceive a dilution of their global stature. Alternately, a larger forum for global governance may be more reflective of the present multi-polar world.

2 **Group-20 (G-20):** G-8 countries, by joining with 12 more other countries formed G-20 with a view to meet the challenges of the globalisation. This is an informal group. The objective of G-20 is to, "promote discussion and study and review policy issues among industrialised countries and emerging markets with a view to promoting international financial stability".

3. G-2O.: Committed to Sustained Growth:

- The G-20 has progressed a range of issues since 1999, including agreement about policies for growth, reducing abuse of the financial system, deliver with financial crises, and combating terrorist financing. At the 2004 meeting in Berlin, members agreed to the G-20 Accord for Sustained Growth (the Accord) and the G-20 Reform Agenda. The Accord lays Out the guidelines that members' experience suggests can foster sustainable economic growth and development, both nationally and globally. The Reform Agenda sets out the steps being taken by each country to implement the Accord. The G-20 countries have committed to reviewing progress In implementing the Accord, and regular publication of an updated Reform Agenda. The G-20 also aims to foster the adoption of internationally recognized standards through the example set by its members in areas such as the transparency of fiscal policy and combating money laundering and the financing of terrorism. In 2004, G-20 countries committed to new higher standards of transparency and exchange of information on tax matters. This aims to combat abuses of the financial system and illicit activities including tax evasion.
- The G-20 has also aimed to develop a common view among members on issues related to further development of the global economic and financial system. This includes providing political momentum for reform of, and strategic direction to, key international economic and financial institutions, like the IMF and World Bank. It also provides support for clear analytic work on key issues, such as demographic change, progress toward regional integration, and understanding International markets, Including markets in goods and services, finance, and energy and resource commodities.For 2008, Brazil proposes dialogue on *Competition in Financial Markets, Clean Energy and Economic Development* and *Fiscal Elements of Growth and Development.* To follow with the discussions, there will be three technical workshops in the first semester and two Deputys Meetings. The objective of these meetings Is to provide an updated view on those themes that will be further discussed on the Ministers' and Governors' Meeting.

4. **Group-77 (G-77):** Seventy seven developing countries formed into Group 77 (G-77). The objective of G-77 are:

- To develop world to articulate and promote collective economic interests.
- To enhance the joint negotiating capacity of the developing countries on all major economic issues in the UN system.
- To promote economic and technical collaboration among developing countries.
- The operation and modalities of work of the G-77 in the various Chapters have certain minimal features in common such as a similarity in membership, decision-making and certain operating methods. A Chairman, who acts as its spokesman, co-ordinates the Group's action in each Chapter. The Chairmanship, which is the highest political body within the organizational structure of the Group of 77, rotates on a regional basis (between Africa, Asia and Latin America and the Caribbean) and is held for one year in all the Chapters. Currently Antigua and Barbuda holds the Chairmanship of the Group of 77 in New York for the year 2008. Ambassador John W. Ashe is Antigua and Barbuda's Permanent Representative to the United Nations and Chairman of the Group of 77 in New York.
- The South Summit is the supreme decision-making body of the Group of 77. It is convened once in every five years. The First and the Second South Summits were held in Havana, Cuba, on 10 — 14 April 2000 and in Doha, Qatar, on 12 — 16 June 2005, respectively. In accordance with the principle of geographical rotation, the Third South Summit is due to be held in Africa in 2010.

5. **Group-is (G-15):** Initially, a group of 15 countries from Asia, Africa and Latin America formed into Group-l5. The objective of G-15 is to foster co-operation and provide input for other international groups like the WTO G-15 and G-7. The Group of Fifteen (G-15) was established at a Summit Level Group of Developing Countries in September 1989, following the conclusion of the Ninth Non-Aligned Summit Meeting in Belgrade. The Group was originally founded by 15 developing countries. While there are now 19 member countries, the original name of the Group has been retained.

The Group was conceived as a small cohesive body of developing countries, but at the same time, fairly representative and having sufficient economic and political weight and countervailing power, to meet on a regular basis at the highest level and make authoritative pronouncements reflecting their common standpoint on the major developments in the world economy and international economic relations. A long-term goal of the G- 15 was to be recognized as a logical dialogue partner of the Group of 7 (G-7,now G-8) highly industrialized countries.

It was decided to set up the G-15 autonomously outside the larger groupings of developing countries, but fully sharing their objectives and world view, having close interaction with them and keeping its projects open for participation by any member of the larger Groups. The above purpose alone was important enough and sufficient to justify the creation of the Group of *15*. But, the Heads of State and Government of the Group decided that in addition to this broader purpose, the G-15 would also take up projects which could bring direct benefits to the peoples of the member States, which could help in enhancing the credibility of the Group, inspire confidence among its member States, and thereby strengthening its unity and cohesion. This, it was expected could enhance the bargaining power of the Group in dealing with developed countries.

Aims and Objectives of G-15:

- To cooperate among developing countries, especially in the areas of investment, trade and technology.
- To act as a catalyst for greater South-South co-operation. The G-15 aims at facilitating national

efforts for development and economic progress. This co-operation is also expected to lend greater cohesion and credibility to developing countries in their efforts to pursue a more positive and productive North-South dialogue.

The developing countries have increased their shares of the world GDP and trade. Much of the increase is accounted for by the members of the G-15, many of which have registered more than proportionate growth in their GDP as compared to developed countries. The G-15 today is thus poised to play its collective role in the international arena more effectively than at the time when it came into existence. During the last decade-and-a-half, the modern technological revolution has gathered further momentum. This has been particularly so in the realms of Information and Communications Technologies (ICT), biotechnology, genetics and genomics.

Another development of momentous significance has been the acceleration in the pace of globalization which, on the one hand, provides unprecedented opportunities for the developing countries to enhance the efficiency and competitiveness of their economies by integrating with the global economy, but which, on the other hand, has the effect of the further marginalization of those who were already marginalized and outside the pale of the market. Through solidarity and co-operation, the G- 15 has the potential to take full advantage of the opportunities presented by globalization and to deal effectively with its discontents.

The 1990s have also witnessed the accentuation of the phenomenon of volatility in the financial markets, exposing developing countries to the risk of frequent economic crises, and even economic meltdown as witnessed in Mexico in 1994, the Republic of Korea and Southeast Asia in 1997/98, Brazil in 1999 and Argentina in 2001.

This has coincided with a virtual dismantling of the international support system for these countries to cope with such crises. The new international financial architecture that is in the process of being put in place is discretionary in character and not rule-based. As a result, political factors, more than economic factors, have come to play a greater role in decision-making on bailing out countries facing such crises. This has created a situation of extreme uncertainty and vulnerability for developing countries, including the members of the *G-15.* There is clearly a need for common strategy to face this situation and for working for an arrangement which is equitable and rule-based. The *G-15* has been, and will remain engaged in this crucial area.

The G- 15 today has a much enhanced prospect and potentiality to influence events and policies in favour of the member countries of the Group as well as the developing countries as a whole. The Group is more relevant today than when it was originally created. The Group has therefore continued to adapt itself to the new circumstances and the changed global situation, while maintaining its overall purpose and objective.

6.7 Summary

However, the benefits of international trade outweigh the problems. Added to this, globalization is the order of the day. Most of the countries eliminated the barriers and paved the way for the growth and expansion of international trade. in fact, international trade, during the third millennium (2001 and beyond) is just an extension to inter-regional business with in a country. Trade policies aim at enlarging international trade by protecting the domestic industry. Instruments of trade policies include: tariffs, subsidies, import quotas, voluntary export restraints, local content requirements and administrative policies. International relations study the factors and activities affecting the external policies of the government. International relations include: tariff policy, international cartels, commodity agreements etc. International conflicts reduce the growth of economies. International law aims at maintaining an orderly system of international relations, International law enables international business to operate smoothly.

6.8 Key Words

- **Tariffs:** Tax or duty imposed on imports and exports is called tariff.
- **Subsidies:** In order to encourage domestic protection and production from the foreign competitors, government pays to a domestic producer by reducing operations cost such payments arc called subsidies.
- **Import Quotas:** Import quota is a direct restriction on the quantity of goods which are imported into a country.
- **Local Content Requirements:** Local content requirement is a condition that requires some specific fraction of a product imported be produced domestically.
- **Administrative Policies:** Administrative policies are bureaucratic rules and procedures which are formulated to make it difficult for imports to enter the country.
- **Voluntary Export Restraints:** A voluntary export restraint is a quota on exports of the domestic firm imposed by the exporting country.
- **National Security:** After liberalization and globalization of Indian economy, Government in India reserved eight strategic industries (from the national security point of view) for exclusive public sector operation.
- **Strategic Trade Policy:** Strategic Trade Policy which advocates protection and government cooperation to certain high tech industries in the developed countries is somewhat similar to the infant industry argument applied to the developing countries
- **International Cartels:** International cartels are agreements among companies or countries, carrying out the same business but located in different countries in order to exert monopolistic competition.
- **Dumping:** Dumping means selling the products at a price less than the on going price in the market or less than the cost of production.
- **International Law:** Individuals are becoming more and more subject to international law such that the law of nations is applicable to individuals in their relations with the states and even to certain interrelationship of individuals.
- **Treaties on Business:** Treaties create obligation on the part of the states and private business houses of the member countries to the treaty.

6.9 Self Assessment Test

1. Explain the need for formulating international trade policy.
2. What are the various instruments of international trade policy?
3. Explain the following. (a) Tariffs *(b)* Subsidies *(c)* Quotas.
4. Why do advanced countries insist on elimination of subsidies?
5. How do you support for the government intervention in formulation of trade policy?
6. Define the term 'International relations.' How does it affect international business?
7. Explain the role of international law on international business.

6.10 References

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Unit - 7 : Trade Blocks

Unit Structure:

7.0 Objectives

After studying this unit, you will be able to understand :

- The meaning and importance of economic integration.
- The structure, purpose and future of the European Union.
- The essence of the North American Free Trade Agreement (NAFTA) and the rationale and impact of NAFTA, on the trade in that region as well as on Global Trade.
- The importance and activities of the Association of South East Asian nations (ASEAN).
- The Latin American Free Trade Association (LAFTA) : its purpose and importance.
- SAARC - South Asian Association for Regional Cooperation and its relevance to the region.
- ESCAP - The Economic and Social Commission for Asia and the Pacific : its purpose and importance.
- The purpose and structure of APEC. (The Asia Pacific Economic Cooperation).
- The trade group in South America called MERCOSUR.
- The Andean Common Market (ANCOM).
- The concept and rationale of Business Centres.
- The implications of Trade Blocks for Business.

7.1 Introduction

As the world is shrinking, because of faster and cheaper transportation and communication, companies are realizing that the global competition is tremendous. In such a competitive scenario, countries seek to integrate with each other to strengthen forces that can help them face the challenges.

This unit discusses regional economic integration. Regional Economic Integration (RET) refers to the political and economic agreement among countries to give preference to member countries of the agreement. For example, regional economic groups might reduce tariffs for member countries while keeping tariffs for non member countries. The lowest level of cooperation usually involves trade, although higher forms of regional economic integration go beyond trade. But trade is usually the crucial factor in any form of regional economic integration. Commodity agreements result in cooperation among producers of commodities, such as the oil-producing countries, or between producers and consumers of commodities such as coffee and tin.

The need to understand the nature of these agreements emerges from the fact that regional trading groups are an important influence on an MNE strategies. Such groups can define the size of the regional market and the rules under which companies must operate. Companies in the initial stages of foreign expansion must be aware of the regional economic groups that include countries with good manufacturing locations or market opportunities. As companies expand internationally, they must change their organizational structure and operating strategies to take advantage of regional trading groups.

7.2 Economic Integration

Most trade groups consist of countries in the same area of the world. Neighboring countries tend to ally for several reasons :

- The distances that goods need to travel between such countries is short.
- Consumers' tastes are likely to be similar, and distribution channels can be easily established in countries situated close by.
- Neighboring countries may have a common history and interests, and may be more willing to coordinate their policies.

7.2.1 Types of Economic Integration

There are four basic types of regional economic integration.

1. **Free Trade Area (FTA)** - The goal of an FTA is to abolish all tariffs between member countries. Free trade agreements usually begin modestly by eliminating tariffs on goods that already have low tariffs, and there is usually an implementation period during which all tariffs are eliminated on all products. At the same time tariffs are being eliminated, the members of the FTA might explore other forms of cooperation, such as the reduction of nontariff barriers or trade in services and investment, but the focus is clearly on tariffs. Additionly, each member country maintains its own external tariff against non-FTA countries.

2. **Customs Union** - Along with eliminating internal tariffs, member countries levy a common external tariff on goods being imported from non-members. For example, the North American Free Trade

Agreement between Canada, the United States, and Mexico has eliminated tariffs on trade among the three countries, but each country maintains a separate tariff with the outside world. If a British company exports a product to the United States, it likely will enter the country at a different tariff rate than if the product were exported to Canada or Mexico because each NAFTA country can set its own external rate. But if a U.S. company were to export a product to the United Kingdom and France, two members of the EU, which is also a customs union, the product would enter both countries at the same tariff rate.

3. **Common Market** - A common market, has all the elements of a customs union but it also allows free mobility of production factors such as labour and capital. Labour, is free to work in any country in the common market without restriction. In the absence of the common market arrangement, workers would have to apply to immigration for a visa.

4. **Economic Integration** - Countries can create even greater social and economic integration by adopting common economic policies, such as fiscal or monetary policies. For example, the EU has established a common currency complete with a common Central Bank. This level of cooperation creates a degree of political integration among member countries, which means they lose a bit of their sovereignty.

7.2.2 Impact of Integration

Economic integration can affect member countries in social, cultural, political, and economic ways. Multi National Enterprises are especially concerned with the economic effects of integration. The position of tariff and nontariff barriers disrupts the free flow of goods, affecting resource allocation. Economic integration reduces or eliminates those barriers for member countries. It produces both static effects and dynamic effects. Static effects are the shifting of resources from inefficient to efficient companies as trade barriers are remobed. Dynamic effects are the overall growth in the market and the impact on a company caused by expanding production and by the company's ability to achieve greater economies of scale. Static effects may develop when either of the following two conditions occur :

1. **Trade Creation** - Production shifts to more efficient producers for reasons of comparative advantage, allowing consumers access to more goods at a lower price than would have been possible without integration. Companies that are protected in their domestic markets face real problems when the barriers are eliminated and they then attempt to compete with more efficient producers. The strategic implication is that companies that might not have been able to export to another country - even though they might be more efficient than producers in that country - are now able to export when the barriers come down. Thus, there will be more demand for their products, and the demand for the protected, less efficient products will fall.

2. **Trade Diversion** - Trade shifts to countries in the group at the expense of trade with countries not in the group, even though the nonmember companies might be more efficient in the absence of trade barriers. Dynamic effects of integration occur when trade barriers come down and the size of the market increases. When the trade barriers come down, the market size confronting a company increases. Because of the larger size of the market, companies can increase their production, which will result in lower costs per unit, resulting in economies of scale.

   Another important dynamic efficet is the increase in efficiency due to increased competition. Many MNEs grow through mergers and acquisitions to achieve the size necessary to compete in the larger market as well as the ability to use greater technology.

Free Trade area	Free trade among members				
Customs union	Free trade among members	Common external commercial policy			
Common market	Free trade among members	Common external commercial policy	Free factor mobility within the market		
Economic union	Free trade among members	Common external commercial policy	Free factor mobility within the market	Harmonised economic policies	
Economic integration	Free trade among members	Common external commercial policy	Free factor mobility within the market	Harmonised economic policies	Supernational organizational structure

Figure 7.1 Characteristics of Regional Integration Types

7.3 Important Regional Trading Groups

There are two ways to look at different trading groups : by **location** and by **type**. There are major trading groups in every region of the world. Each regional group fits into one of the types free trade area, customs union, common market, or economic integration, Most commonly found are FTA or a customs union.

Companies are interested in regional trading groups as it gives them an opportunity explore their markets, access new sources of raw materials, and new production locations. The sections that follow will discuss the major Regional Trading Groups and analyze thier purpose and importance.

7.3.1 European Union:

The largest economic group is the Eureopean Union. It began as a customs union, but the formation of the European Parliament and the establishment of a common currency, the euro, make the EU the most ambitious regional trade group. The economic and human destruction caused by World Word II made European political leaders realize that greater cooperation among their countries would help Europe's recovery. Many organizations were formed, including The European Economic Community (EEC), which eventually emerged as the organization that would bring together the countries of Europe into the most powerful trading bloc in the world. The EEC, later called the European Community (EC), and finally the European Union (EU), aimed to abolish internal tariffs in order to integrate European markets and ensure economic cooperation and help avoid further political conflict. The following are the members of EU:

1. Austria
2. Belgium
3. Bulgaria
4. Cyprus
5. Czech Republic

6. Denmark
7. Estonia
8. Finland
9. France
10. Germany
11. Greece
12. Hungary
13. Ireland
14. Italy
15. Latvia
16. Lithuania
17. Luxemlrough
18. Malta
19. Netherlands
20. Poland
21. Porugal
22. Romania
23. Slovakia
24. Slovenia
25. Spain
26. Sweden
27. United Kingdom

<u>Some Facts about EU</u>
27. Countries
23. Languages
497. Million Citizen
4.3 Million Sq. km
GDP $ 14.7 Trillion

Organizational Structure:

The European Union includes many governing bodies, among which are the European Commission, European Council, European Parliament, and the European Court of Justice. To be successful in Europe, a company needs to understand the governance of the EU, as well as the governance process of each of the individual European countries in which it is investing or doing business. These institutions, decide upon the parameters under which the company must operate, so management needs to understand the institutions and how they make decisions that could affect corporate strategy.

1. European Commission - The Commission provides the EU's political leadership and direction. The original objective was for the Commission to act as a supranational government for Europe. There are three distinct functions of the Commission :

- . Initiating proposals for legislastion.
- Guardian of the treaties
- Manager and executor of Union policies and of international trade relationship.

The Commission manages the annual budget of the EU, manages the EU, and negotiates trade agreements.

The Commission has always had a significant amount of power in the EU. However, in 1999, the Commission came under severe criticism, and its power was seriously curtailed. The power is now shifting to the Council, which more clearly represents the interests of the governments and is more likely to consider the interests of individuals in the EU.

2. European Council - The Council is also known as the Council of Ministers, which is composed of different ministers of the member countries. However, this doesn't mean that there is just one member of the Council for each EU member country. There are more than 25 different councils, such as Foreign Affairs, Economy and Finance, and Agriculture.

3. European Parliament - The Parliament is composed of 626 members who are elected every five years, and its membership is based on country population. The three major responsibilities of the Parliament are legislative power, control over the budget, and supervision of executive decisions. The Commission presents community legislation to the Parliament. Parliament must approve the legislation before submitting it to the Council for adoption.

4. European Court of Justice - The Court of Justice ensures consistent interpretation and application of EU treaties. Member states, EC institutions, or individuals and companies may bring cases to the Court. The Court of Justice is an appeals court for individuals, firms, and organizations fined by the Commission for infrin ing Treaty Law. The Court of Justice is relevant to MNCs because it deals mostly with economic matters.

- **The Single European Market**

The European Union has been moving toward a single market since the passage of the Single European Act of 1987. The act includs the elimination of the remaining barriers to a free market, such as customs posts, different certification procedures, rates of value-added tax, and excise duties.

The EU Web site emphasizes that the European Union is today the leading player in international trade, ahead of the United States and Japan. At a time of strong growth in international trade, it accounts for a fifth of world trade. The Union's influence on the international stage rests upon its ability to negotiate with its trade partners as a single entity.

During the formation of the European Union, the organizing countries focused mainly on economic integration and left foreign policy to the individual countries. Realizing the benefits a common foreign policy would be to the EU, member countries began formalizing objectives on armed conflicts, human rights, and other international foreign policy issues in 1993. Progress in this area has been slow due to differences in member opinion.

- **The Euro**

The EU nations signed the Treaty Maastricht in 1992, which aimed to accomplish two goals : political union and monetary union. The decision to move to a common currency in Europe has eliminated currency as a barrier to trade. To replace each national currency with a single European currency called the euro, the countries had to coverage their economic policies first. It is not possible to have 15 different monetary policies and one currency. Those that met the criteria are part of the **European Monetary Union** (EMU).

After a great deal of effort, 11 of the 15 countries in the EU joined the EMU on Junary 1, 1999. Greece joined on January 1, 2001. Those participating in the euro later are the United Kingdom, Sweden, and Denmark The euro is being administered by the European Central Bank (ECB), which was established on July 1, 1998. The ECB has been responsible for setting monetary policy and for managing the exchange-rate system for all of Europe since January 1,1999.

The EU has also signed numerous free trade agreements with other countries around the world, making it the largest trading bloc in the world. This means that companies doing business in one EU country have access to a much larger market than anywhere else in the world.

- **Impact of EU on Corporate Strategy**

The EU is a tremendous market in terms of both population and income, and so companies cannot ignore it. Merger and acquisition activity has picked up in Europe. The market in Europe is still considered fragmented and inefficient compared with the United States, so mergers, takeovers and spinoffs will continue in Europe for many years. U.S. companies are buying European companies to gain a market presence and to get rid of competition.

European firms are also acquiring other European firms to improve their competitive advantage against U.S. companies and to expand their market presence. A good example is the purchase of Promodes Group, a French retailer, by Carrefour, another French retailer. That merger resulted in the creation of the number-one retailer in Europe. Carrefour, in second place worldwide behind Wal-Mart, is still larger than Wal-Mart in foreign markets and is a formidable challenger to the number-one retailer in the world.

Europe is moving closer together through the euro and the Single Market program, yet it is still not as homogeneous as the U.S. market. Differences in languages, cultures, and governments still splinter Europe, and the eventual addition of the 13 new countries will create even more divisions in the market. Thus, companies need to develop a pan-European strategy without sacrificing diferent national strategies.

- **The Future of EU**

Five fundamental shifts that have occurred in the EU that will dramatically affect its future :

1. A Change in the Franco-German Balance - France had always had political control of the EU and could take the high road as a result of World War II. However, Germany's confidence has returned as a result of the reunification of the East and West, and Germany is now the largest and richest country in Europe. Germany may be the only country that can lead Europe in the future.
2. A sense that the EU should possess a capacity for collective military action separate or separable from NATO - This was confirmed in the Kosova confict in which the United States took control of a European conflict, and it could be an issue in the war on terrorism.
3. The introduction of the euro Currency 1999
4. The weakening of the European Commission and the ascendancy of national governments in controlling the destiny of the EU.

7.4 North American Free Trade Agreement (NAFTA)

NAFTA, which includes Canada, the United States, and Mexico, came into effect in 1994. The United States and Canada historically have had various forms of mutual economic cooperation. They signed the Canada-U.S. Free Trade Agreement effective January 1, 1989, which eliminated all tariffs on bilateral trade by January 1, 1998. In February 1991, Mexico approached the United States to establish a free-trade agreement. The formal negotiations that began in June 1991 included Canda. The resulting North American Free Trade Agreement became effective on January 1, 1994.

NAFTA has a logical rationale, in terms of both geographic location and trading importance. Although Canadian-Mexican trade was not significant when the agreement was signed, U.S.-Mexican and U.S.-Canadian trade were. The two-way trading relationship between the United States and Canada is the largest in the world. NAFTA is a powerful trading bloc with a combined population and total GNI greater than the 15-member EU.

The following issues come under the purview of NAFTA :

- **Market access** - tariff and nontariff barriers, rules of origin, and government procurement.
- **Trade rules** - safeguards, subsidies, countervailing and antidumping duties, health and safety standards.

- **Services** - provides for the same safeguards for trade in services (consulting, engineering, software, etc.) that exist for trade in goods.
- **Investment** - establishes investment rules governing minority interests, portfolio investment, real property and majority-owned or controlled investments from the NAFTA countries; in addition, NAFTA coverage extends to investments made by any comapny incorporated in a NAFTA country, regardless of country of origin.
- **Intellectual property** - all three countries pledge to provide adequate and effective protection and enforcement of intellectual property rights, while ensuring that enforcement measures do not themselves become barriers to legitimate trade.
- **Dispute settlement** - provides a disputes-settlement process that will be followed; desired to keep countries from taking unilateral action against an offending party.

NAFTA provides the static and dynamic effects of economic integration. For example, Canadian and U.S. consumers benefit from lower-cost agricultural products from Mexico, a static effect of economic liberalization. U.S. producers also benefit from the large and growing Mexican market, which has a huge appetite for U.S. products - a dynamic effect.

NAFTA is also a good example of trade diversion. Many U.S. and Canadian companies have established manufacturing facilities in Asia to take advantage of cheap labour. Now, U.S. and Canadian companies establish manufacturing facilities in Mexico rather than in Asian countries to take advantage of relatively cheap labour. For example, IBM is marking computer parts in Mexico that were earlier made in Singapore.

7.4.1 Concept of Rules of Origin and Regional Content

An important component of NAFTA is the concept of rules of origin and regional content. Because NAFTA is a free trade agreement and not a customs union, each country sets its own tariffs to the rest of the world. That is why a product entering the United States from Canada must have a commercial or customs invoice that identifies the product's initial origin. Otherwise, an exporter from a third country would always ship the product to the NAFTA country with the lowest tariff and then re-export it to the other two countries duty-free.

7.4.2 Sepecial Provisions of NAFTA for Labour and Environmental Standards

Most free trade agreements in the world are based solely on one goal : to reduce tariffs. However, NAFTA is a very different free trade agreement. Due to strong objections to the agreement by labour unions and environmentalists, two side agreements covering those issues were included in NAFTA. When first debating NAFTA, opponents worried about the potential loss of jobs in Canada and the United States to Mexico as a result of Mexico's cheaper wages, poor working conditions, and lax environmental enforcement. NAFTA opponents, particularly U.S. union organizers, thought companies would close down factories in the north and set them up in Mexico. As a result, the labour lobby in the United States forced the inclusion of labour standards, such as the right to unionize, and the environmental lobby pushed for an upgrade of environmental standards in Mexico and the strengthening of compliance.

7.4.3 Impact of NAFTA on Trade, Investment, and Jobs

The test of any regional trading group is whether it creates trade and jobs. Since NAFTA has been in place, the United States, Canada, and Mexico have all tripled their business dealings, with trade among the countries equaling $1.7 billion per day. U.S. exports to Mexico have increased, but Mexican exports to the U.S. have surged even more - $135.9 billion in 2000 compared to $49.5 billion in 1994.

The investment and employment pictures are far more complicated. One concern for U.S. workers was that investment would move to Mexico due to that country's lower wages and lax environmental standards. Wages are significantly lower in Mexico than they are in the United States and Canada. When NAFTA was signed, companies like IBM and Canon began investing in Mexico instead of Asia for certain types of manufacturing. They could enjoy many tax and tariff exemptions, labour was plentiful and cheap, and high U.S. demand was just miles away. Foreign investment in Mexico rose from $4 billion per year in 1993 to $11.8 billion per year in 1999. However, when NAFTA required Mexico to strip the maquiladoras (companies on the Mexican border) of their duty-free status in 2001, foreign companies started looking elsewhere. This was also compounded by the weakening U.S. economy and the stronger 'peso'. Companies like Sanyo, Canon, and French battery producer Saft are now leaving Mexico and relocating to China, Vietnam, and Guatemala, where labour is cheaper.

7.4.4 The Role of NAFTA

When the United States began its discussions with Mexico and Canada, it perceived a future effort to pull together North, Central, and South America into an "Enterprise of the Americas." For the last seven years, representatives from 34 countries have been meeting to join the Americas into the Free Trade Area of the Americas (FTAA). Although negotiations have been slow, if adopted, the FTAA will be the world's largest trade block, with a population of 800 million and $11 trillion in combined GDP. Canada and Mexico have both entered into free trade agreements with Chile, perceived to be the next country that could join NAFTA, and the agreements were modeled after NAFTA. Free trade in the Americas will benefit companies greatly.

Mexico also entered into a free trade agreement with the European Union on July 1, 2001, that will end all tariffs on bilateral trade by 2007. EU officials feel that the FTA is important for them, because their share of trade with Mexico fell from 9 percent in 1993 to 6 percent in 2000.

7.4.5 Implications of NAFTA on Corporate Strategy

Several predictions were made when NAFTA was signed. One prediction was that companies would look at NAFTA as one big regional market, allowing companies to rationalize production, products, financing, etc. That has largely happened in a number of industries-especially in automotive products and in electronics (e.g., in computers). Each country in NAFTA ships more automotive products, based on specialized production, to the other two countries than any other manufactured goods. Employment has increased in the auto industry in the United States since NAFTA was established, even as it has declined in Mexico because of productivity. Rationalization of automotive production has taken place for years in the United States and Canada, but Mexico is a recent entrant. Auto manufacturing has moved into Mexico from all over the world. Over 500,000 Mexicans make parts and assemble vehicles for all of the world's major auto producers. NAFTA's rules of origins requiring 62.5 percent regional content have forced European and Asian automakers to bring in parts suppliers and set up assembly operations in Mexico.

A second prediction was that sophisticated U.S. companies would run Canadian and Mexican companies out of business once the markets opened up. That has not happened. In fact, U.S. companies along the border of Canada are finding that Canadian companies are generating more competition for them than low-wage Mexican comapnies. Also, many Mexican companies have restructured to compete with U.S. and Canadian companies. The lack of protection has resulted in much more competitive Mexican firms. NAFTA has forced companies from all three countries to reexamine their strategies and determine how best to operate in the market.

Finally, Mexico was looked at as a source of cheap labour not as a consumer market. Initially, the excitement over Mexico for U.S. and Canadian companies has been the low-wage environment. However, as Mexican incomes rise- demand is rising for foreign products. U.S. and Canadian companies today are making the transition to Mexico as a significant final consumer market.

7.5 Association of South East Asian Nations (ASEAN)

The Association of South East Asian Nations (ASEAN), organized in 1967, comprises Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam. It promotes cooperation in many areas, including industry and trade. Member counties are protected in terms of tariff and nontariff barriers. They hold promise for market and investment opportunities because of their large market size (500 million people). On January 1, 1993, ASEAN officially formed the ASEAN Free Trade Area (AFTA). AFTA's goal is to cut tariffs on all intra zonal trade to a maximum of 5 percent.The weaker ASEAN countries would be allowed to phase in their tariff reductions over a longer period.

Many MNEs are hoping that ASEAN countries will work harder to loosen their borders. Companies such as BMW, Matsushita Eelectrical Industrial, Honda Motor, and Procter & Gamble have operations in the ASEAN countries but aren't able to expand to their full potential because ASEAN countries aren't cooperating with each other. Malaysia, Singapore, Thailand, and the Philippines are still passing protectionist measures which downgrade the effectiveness of AFTA and shrink trade. The ASEAN now constitutes a larger-market for Japan than does the United States. For two of the members-Indonesia and Malaysia-Japan is now the leading trade partner for exports as well as imports. The ASEAN regions are richly endowed with natural resources. This region accounts for a large share of the world's natural rubber, palm oil and tin. It is also an important producer of sugar, coffee, timber, petroleum, nickel, bauxite, tungsten and coal.China and ASEAN have signed a major deal, in November 2002, to usher in the world's largest free trade zone ecompassing mroe than 1.7 billion people struggling to attain prosperity after having remained in poverty. The agreement came after talks with in the leaders of ASEAN as well as with China, South Korea and Japan. Fre trade area between Southeast Asia's 10 nations and Japan could be a reality within 10 years.

7.6 European Free Trade Association (EFTA)

The **European Free Trade Association** or **EFTA** is a free trade organization between four European countries that operates parallel to, and is linked to, the European Union (EU). EFTA was established on 3 May 1960 as a trade bloc-alternative for European states who were either unable to, or chose not to, join the then-European Economic Community (EEC) which has now become the EU. The Stockholm Convention, establishing EFTA, was signed on 4 January 1960 in Stockholm by seven countries. Today's EFTA members are Liechtenstein, Iceland, Norway, and Switzerland—the latter two being founding members. The initial Stockholm Convention was superseded by the Vaduz Convention, which provides for the liberalization of trade among the member states.

EFTA states have jointly concluded free trade agreements with a number of other countries. Three of the EFTA countries are part of the European Union Internal Market through the Agreement on a European Economic Area (EEA), which took effect in 1994; the fourth, Switzerland, opted to conclude bilateral agreements with the EU. In 1999, Switzerland concluded a set of bilateral agreements with the European Union covering a wide range of areas, including movement of persons, transport, and technical barriers to trade. This development prompted the EFTA states to modernize their Convention to ensure that it will continue to provide a successful framework for the expansion and liberalization of trade among them and with the rest of the world.

How EFTA came into Existence?:

British reaction to the creation of the EEC was mixed and complex. Consequently, in 1963 (after the creation of EFTA), France vetoed British membership. Britain was also preoccupied with the Commonwealth, which was in a critical period. The UK brought together several countries (including some bordering the EEC) and decided to form the European Free Trade Association in about 1959, soon after the establishment of the 6-nation EEC (France, Germany, Italy, Belgium, Luxembourg, and the Netherlands; these last three are also known as the Benelux Union).

On 4 January 1960, the Treaty on European Free Trade Association was initiated in the Golden Hall of the Prince's Palace of Stockholm. This established the progressive elimination of customs duties on industrial products, but did not affect agricultural products or maritime trade. After the accession of Denmark and the UK to the EEC, EFTA began to falter. For this reason most countries eased or eliminated their trade tariffs in preparation to join the EEC. Four members remain: Switzerland, Norway, Liechtenstein and Iceland. Iceland applied for EU membership in 2009 following the 2008–2011 Icelandic financial crises.

EFTA is governed by the EFTA Council and serviced by the EFTA Secretariat. In addition, in connection with the EEA Agreement of 1992, two other EFTA organizations were established, the EFTA Surveillance Authority and the EFTA Court. The EFTA Surveillance Authority and the EFTA Court regulate the activities of the EFTA members in respect of their obligations in the European Economic Area (EEA). Since Switzerland is not an EEA member, it does not participate in these institutions. The EFTA Surveillance Authority performs the European Commission's role as "guardian of the treaties" for the EFTA countries, while the EFTA Court performs the European Court of Justice's role for those countries.

The EFTA Secretariat is headquartered in Geneva, Switzerland. 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). The EFTA members, except for Switzerland, are also members of the European Economic Area (EEA).

7.7 Latin American Integration Association (LAIA)

The **Asociación Latinoamericana de Integración** (the **Latin American Integration Association**; known as **ALADI** or, by the English acronym **LAIA**) is a Latin American trade integration association, based in Montevideo. Its main objective is the establishment of a common market, in pursuit of the economic and social development of the region. Signed on August 12, 1980, the Montevideo Treaty is an international legal framework that establishes and governs the Latin American Integration Association. It sets the following general guidelines regarding trade relations between signatory countries: pluralism, convergence, flexibility, differential treatment and multiplicity.

The LAIA emerged from the **Latin American Free Trade Association** (LAFTA) which was created in the 1960 Treaty of Montevideo by Argentina, Brazil, Chile, Mexico, Paraguay, Peru, and Uruguay. The signatories hoped to create a common market in Latin America and offered tariff rebates among member nations. LAFTA came into effect on January 2, 1962. When the trade association began, it had seven members and its main goal was to eliminate all duties and restrictions on the majority of their trade within 12 years. By the late 1960s, the area of LAFTA had a population of 220 million and produced about $90 billion of goods and services annually. It also had an average per capita gross national product of $440.

The goal of the LAFTA is the creation of a free trade zone in Latin America. It should foster mutual regional trade among the member states, as well as with the US and Canada, the Pacific Union, the African Union, and the European Union. To achieve these goals, the following institutions were created:

- The council of foreign ministers
- A conference of all participating countries
- A permanent council

The LAFTA agreement had important limitations: it only refers to goods, not to services, and it does not include a coordination of policies. Compared to the European Union, the political and economic integration was very limited.

By 1970, LAFTA expanded to include four more Latin American nations: Bolivia, Colombia, Ecuador, and Venezuela. It now consisted of 11 nations. In 1980, LAFTA reorganized into the Latin American Integration Association (ALADI). LAFTA brought many new positive changes to Latin America. With LAFTA in place existing productive capacity could be used more fully to supply regional needs, industries could reduce costs as a result of potential economies through expanded output and regional specialization, and attraction to new investment occurred as a result of the regional market area.

Although LAFTA has brought many constructive results, it has also brought problems to individual nations and to Latin America as a whole. Some of the problems which individual countries face are the way they are grouped together by their economic strengths according to LAFTA. The grouping was originally Argentina, Brazil, and Chile in one group, Colombia, Chile, Peru, Uruguay, and Venezuela in the second group, and the last group which included Bolivia, Ecuador, and Paraguay. There is a problem in this classification because it ignores economic and other differences between the countries. Problems which Latin America faced as a whole had to do with many of the nations in the continent being underdeveloped. The Free Trade Agreement was seen as a way of the countries having greater economic interactions among each other and thus improving the economic state of the poorer nations.

Any Latin-American country can join the 1980 Montevideo Treaty. Cuba was the last to accede, becoming a full member on August 26, 1999. In addition, LAIA is also open to all Latin American countries through agreements with other countries and integration areas of the continent, as well as to other developing countries or their respective integration areas outside Latin America. LAIA is now the largest Latin-American group of integration. It is responsible for regulations on foreign trade which includes regulations on technical measures, sanitary regulations, environment protection measures, quality control measures, automatic licensing measures, price control measures, monopolistic measures, as well as other measures.

The LAIA promotes the creation of an area of economic preferences in the region, aiming at a Latin American common market, through three mechanisms:

- Regional tariff preference granted to products originating in the member countries, based on the tariffs in force for third countries
- Regional scope agreement, among member countries
- Partial scope agreements, between two or more countries of the area

Either regional or partial scope agreements may cover tariff relief and trade promotion; economic complementation; agricultural trade; financial, fiscal, customs and health cooperation; environmental conservation; scientific and technological cooperation; tourism promotion; technical standards and many other fields. As the Montevideo Treaty is a "framework treaty", by subscribing to it, the governments of the member countries authorize their representatives to legislate through agreements on the economic issues of greatest importance to each country.

A system of preferences — which consists of market opening lists, special cooperation programs (business rounds, reinvestment, financing, technological support) and countervailing measures on behalf of the landlocked countries — has been granted to the countries deemed to be less developed (Bolivia, Ecuador and Paraguay), to favour their full participation in the integration process. As the institutional and normative "umbrella" of regional integration that shelters these agreements as well as the sub-regional ones (Andean Community, MERCOSUR, G-3 Free Trade Agreement, etc.) the Association aims to support every effort to create a common economic area.

7.8 South Asian Association for Regional Cooperation (SAARC)

The South Asian Association for Regional Cooperation (SAARC) involving seven countries, namely, India, Bangladesh, Pakistan, Nepal, Bhutan, Sri Lanka and Maldives, was formally launched in December 1985 these neighbours had come together in an act of faith. The birth of SAARC was a logical response to the problems facing the region. The Secretariat of the Association is at Kathmandu, Nepal.

The foundamental goal of SAARC is to accelerate economic and social development through optimum utilisation of their human and material resources. The objectives of the Association areas follows :

1. To promote the welfare of the people of South Asia and to improve their quality of life.
2. 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 realise their full potential.
3. To promote and strengthen collective self-reliance among the countries of South Asia.
4. To contribute to mutual trust, understanding and appreciation of each other's problems.
5. To promote active collaboration and mutual assistance int he economic, social, cultural, technical and scientific fields.
6. To strengthen cooperation with other developing countries.
7. To strengthen cooperation among themselves in international forums on matters of common interests.
8. To cooperate with international and regional organisations with similar aims and purposes.

SAARC also adheres to the following principles:

1. Cooperation within the framework of the Association 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.
2. Such cooperation shall not be a substitute for bilateral cooperation but shall complement them.
3. Such cooperation shall not be inconsistent with bilateral and multilateral obligations.

With about 1200 million inhabitants, the SAARC accounts for over one-fifth of the world population. The density of population is the SAARC countries, which have only about 3.3 per cent of the world's land area, is very high, nearly double when compared to the average density of the low income economies as a whole. A major share of the world's poor lives in these countries. All these are low income economies.

India has about two-thirds of the total population of the Association. On the other extreme is the tiny country of Maldives with a land area of 298 sq.kms, inhabited by about 2 lakh people. Bhutan is a comparatively small country, with a total population much less than that of population of Bangalore, where the second SAARC summit was held. Sri Lanka is an island and Maldives an archipelago, Nepal and Bhutan are land-locked countries for whom the easiest entry to the sea routes is through the ports of India and Bangladesh. Despite the growing importance of the services and industrial sectors in these countries, the majority of the population still derives its livelihood from agriculture.

Increased intra-regional trade is a major means of promoting regional economic cooperation. In South Asia, such trade, at present, is at a low level. Intra-regional exports and imports of these countries have generally formed less than 10 per cent of world trade of each country, except for Nepal's trade which is especially high because of its trade with India, and for India, trade with the region, which because of its size, remains a small percentage (two or three per cent) of the total. In general, there has also been a decline in the intra-regional trade of each country during the last decade or so, pointing to a more rapid expansion of trade with extra-regional countries - developed and developing.

Some of the member countries are major exporters of certain commodities and, therefore, major competitors in the international market. For example, jute exports by India and Bangladesh and tea exports by Sri Lanka and India. SAARC aims to become a forum to help avoid unhealthy competition in such areas and to help formulate joint strategies to get a better deal, particularly for the primary commodities in the international market. Cooperation may also provide better scope of offshore or third country trading, utilising the expertise of organisations like the STC and MMTC. The scope of beneficial counter trade among the member countries also needs to be fully explored.

The member countries of SAARC have many common features and problems which are characteristic of the developing countries. There are a number of areas which offer scope for development through mutual help and cooperation. Some such areas have already been identified and some follow up has been made by making organisational arrangements to forge greater cooperation and interdependence among the people of the region in meteorology, health, civil aviation, shipping, agriculture, communication and renewable sources of energy.

There are, however, a number of important problems which affect the relationships among these countries. India has both the advantages and disadvantages of all other members being her neighbours. The size of India, large as it is, geographically separates some of the members. The dominant position of India, as a result of resource endowments and developments in a number of fields, while mostly considered as assets, are not always taken well by some of the members. Border disputes, ethnic issues and differences in political outlooks and affiliations, cause mutual mistrust among the members. There are no signs of substantial improvement of the situation in the near future.

7.8.1 SAPTA:

The sixth SAARC Summit held in Colombo in 1991 strongly mooted the idea of a SAARC Preferential Trading Arrangement (SAPTA) and the Foreign Ministers of all the member states (India, Pakistan, Bangladesh, Nepal, Sri Lanka, Bhutan and Maldive) signed the Agreement on 2 April 1993 during the seventh SAARC Summit in Dhaka. SAPTA became effective from 7 December 1995.

The basic principles of SAPTA are as follows :

1. Overall reciprocity and mutuality of advantages.
2. Step-by-step negotiations and extension of preferential trade arrangement in stages.
3. Inclusion of all types of products - raw, semi-processed and processed.
4. Special and favourable treatment to Least Developed Countries (LDCs).

The special treatment of LDCs include allowance of favourable terms for technical points, application of relaxed rules of origin, favourable terms for technical assistance, duty-free access, deeper tariff preferences, removal of non-tariff and para-tariff barriers, negotiation of long-term contracts to support sustainable exports and provision of special facilities with regard to shipping and documentation, preparation and establishment of industrial and agricultural projects, training facilities and support to export marketing, etc. possibly linked to cooperative financing and buyback arrangements.

The share of intra regional trade in the total trade of SAARC countries is very insignificant. This has not increased even after the formation of the SAARC. In fact, there was some fall in the intra-regional trade after the coming into effect of the Association. During the decade commencing in 1985, it declined from 4.5 per cent to 3.5 per cent. The share of trade of individual countries within the region varies. While the share of the region in the total exports of Maldives, Nepal (17-18 per cent in 1994) and Bangladesh (12.8 per cent) is fairly high, that of India (0.5 per cent) and Pakistan (1.6 per cent) is very low.

All the SAARC countries have implemented substantial reduction in tariffs and also modified their tariff structures as part of the on-going economic policy reforms. These changes have been carried out with a view to improving the efficiency of domestic industries. This process in itself should help the expansion of intra-regional tade. But the presence of non-tariff barriers in diferent forms are acting as constraints to realise the potential for trade expansion.

The SAARC Preferential Trading Arrangement (SAPTA) is expected to play an important role in boosting the intra-regional trade. This preferential arrangement would benefit SAARC countries due to the following reasons :

1. The countries can substantially reduce the transport and transit cost because of the geographical continuity among the members.
2. Capital goods produced within the region may be more compatible to the factor endowments of member states than those imported from developed countries.
3. The increasing competition among the member states would result in technical efficiency in existing industry as marginal firms might be forced to reduce their cost. Resources will be reallocated away from less efficient firms and monopolies protected by the tariff wall will no longer be in a sheltered position.
4. As economic ties get stronger and countries become committed to common economic goals, political problems will gradually recede. When economic benefits gain significance, amicable environment may evolve for dissolving political problems.
5. Regional cooperation may also pave the way for regional banks or corporation which might be influential in promoting regional investment in larger projects.

7.9 Economic and Social Commission for Asia and the Pacific (ESCAP)

The **Economic and Social Commission for Asia and the Pacific** (**UNESCAP** or **ESCAP**), located in Bangkok, Thailand, is the regional arm of the United Nations Secretariat for the Asian and Pacific region. It was established in 1947 (then as the **UN Economic Commission for Asia and the Far East - ECAFE**) to encourage economic cooperation among its member states. The name was changed to the current in 1974. It is one of five regional commissions under the administrative direction of United Nations headquarters. The ESCAP has 53 member States and nine Associate members, and reports to the UN Economic and Social Council (ECOSOC). As well as countries in Asia and the Pacific, it includes France, the Netherlands, the United Kingdom and the United States. The ESCAP is headed by Executive Secretary Noeleen Heyzer of Singapore. Ms. Heyzer is the first woman to head ESCAP, which is the biggest of the UN's five regional commissions, both in terms of population served and area covered. ESCAP's regional focus is managing globalization through programs in environmentally sustainable development, trade, and human rights.

The United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) is the regional development arm of the United Nations for the Asia-Pacific region. With a geographical scope that stretches from Turkey in the west to the Pacific island nation of Kiribati in the east, and from the Russian Federation in the north to New Zealand in the south, ESCAP is the most comprehensive of the United Nations five regional commissions. It is also the largest United Nations body serving the Asia-Pacific region with over 600 staff.

Established in 1947 with its headquarters in Bangkok, Thailand, ESCAP seeks to overcome some of the region's greatest challenges. It carries out work in the following areas:

- Macroeconomic Policy and Development
- Statistics
- Sub-regional activities for development
- Trade and Investment
- Transport
- Environment and sustainable development
- Information and Communications Technology and Disaster Risk Reduction
- Social Development

ESCAP focuses on issues that are most effectively addressed through regional cooperation, including:

- Issues that all or a group of countries in the region face, for which it is necessary to learn from each other;
- Issues that benefit from regional or multi-country involvement;
- Issues that are trans—boundary in nature, or that would benefit from collaborative inter-country approaches;
- Issues that are of a sensitive or emerging nature and require further advocacy and negotiation.

ESCAP secretariat comprises the Office of the Executive Secretary, seven substantive Divisions, the Administrative Services Division, and the Programme Management Division. The implementation of ESCAP's programmes is supported by the regional institutions and the sub-regional offices.

7.10 Asia Pacific Economic Cooperation (APEC)

APEC, the Asia Pacific Economic Cooperation was formed in November 1989 to promote multilateral economic cooperation in trade and investment in the Pacific Rim. It is composed of 21 countries that border the Pacific Rim - both in Asia as well as the Americas.

To accomplish its objectives, APEC leaders committed themselves to achieving free and open trade in the region for the industrial nations (which generate 85 percent of the regional trade) and for the rest of the members.

APEC has the potential to become a significant economic bloc, especially because it generates such a large percentage of the world's output and merchandise trade. APEC is trying to establish "open regionalism", whereby individual member countries can determine whether to apply trade liberalization to non-APEC countries on an unconditional, most-favored-nation basis or aon a reciprocal, free trade agreement basis. The key will be whether or not the liberalization process continues at a good pace. The problem withAPEC is its size. A major reason why regional integration like the EU and NAFTA work is because of close geographic proximity and a unity of purpose. Firstly, APEC has too many countries with diverse interests. Secondly, itr was established as a counterforce to NAFTA. It is to maintain serious progress for something borne out of a defensive rather than an offensive strategy.

7.11 Mercado Comun Del Sur (MERCOSUR)

There has been a move to establish a Latin American Common Market consisting of Brazil, Argentina, Chile, Uruguay and Paraguay. The Southern Cone Common Market (Mercado Comun del Sur - MERCOSUR) consisting of Argentina, Brazil, Paraguay and Uruguay was formed in 1991. MERCOSUR has a subregional group of ALADI. MERCOSUR is significant because of its size : The four original members generate 80 percent of South America's GNP. In addition, MERCOSUR has signed free trade agreements with Bolivia and Chile and is negotiating with the EU and other countries to do the same. MERCOSUR is also trying to become a customs union, but as of the end of 2002, that had not happened. Argentina's economic crisis in 2002 spilled over into Brazil and Uruguay and is threatening the stability of the entire region. The dramatic fall in the value of the Argentine 'peso' changed the trading structure in MERCOSUR, making Argentine products cheaper but making it more difficult for Argentine tourists to travel to the resort areas in Brazil.

The Mercosur, the world's third-largest customs union, announced in May 2000, the decision to transorm the bloc into a common market. In the beginning it would not have a common currency but it may be adopted later. The member nations decided to co-ordinate debt and deficit goals because it is for the good of the region, and they felt that "it is perfectly possible for different countries with different monetary policies to work together toward economic stability." The Mercosur bloc links 210 million people who produced more than $1 trillion in goods and services.

7.12 Andean Common Market (ANCOM)

Although the Andean Common Market (ANCOM) is not as significant economically as MERCOSUR, it is the second-most important regional group in South America. The Andean Group has been around since 1969. It was revived in 1991 and includes Bolivia, Colomia, Ewador, Peru and Venezuela. However, its focus has shifted from one of isolationism and stratism (placing economic control in the hands of the state - the central government) to being open to foreign trade and investment.

7.13 Business Centres

A **Business Centre** refers to a city or part of a metropolitan city that is dedicated to commercial activity. Several major cities of the world have Business centers which facilitate Business meetings and talks. A Business Centre may have large convention halls, exhibition halls, meeting and conference halls, offices and information centers. In essence these are places which are perceived as providing a platform for business to take place.

A **business park** or **office park** is an area of land in which many office buildings are grouped together. All of the work that goes on is commercial, not industrial or residential. These are popular in many suburban locations, where development is cheaper because of the lower land costs and the lower building costs for building wider, not necessarily higher. They are also often located near motorways or main roads.

7.14 Implications of Trading Blocks for Business

We have studied that a **trade bloc** is a type of intergovernmental agreement, often part of a regional intergovernmental organization, where regional barriers to trade, (tariffs and non-tariff barriers) are reduced or eliminated among the participating states.

One of the first economic blocs was the German Customs Union (*Zollverein*) initiated in 1834, formed on the basis of the German Confederation and subsequently German Empire from 1871. Surges of trade bloc formation were seen in the 1960s and 1970s, as well as in the 1990s after the collapse of Communism. By 1997, more than 50% of all world commerce was conducted under the auspices of regional trade blocs. This shows the deep impact of trading blocs on World Trade.

The members of successful trade blocs usually share four common traits:

- Similar levels of per capita GNP,
- Geographic proximity,
- Similar or compatible trading regimes,
- Political commitment to regional organization.

Advocates of worldwide free trade generally oppose trading blocs, which, they argue, encourage regional as opposed to global free trade. The debate continues whether regional trade blocs are leading to a more fragmented world economy or encouraging the extension of the existing global multilateral trading system. Trade blocs can be stand-alone agreements between several states (such as the North American Free Trade Agreement (NAFTA) or part of a regional organization (such as the European Union). Depending on the level of economic integration, trade blocs can fall into different categories, such as: preferential trading areas, free trade areas, customs unions, common markets and economic and monetary unions. But whatever the form every one of these trade blocs plays a significant role in the Global Business scenario.

7.15 Summary

There has been a worldwide trend towards forming new regional arrangements and strengthening the existing ones. Inspired by the European Economic Community (EEC), now more popularly known as the European Union (EU), several regional integration schemes have been formed by the developing countries, particularly in Latin America and Africa. Since the 1980s regionalism is "back" and has engulfed all major players in the world economy.

The motivation to form trading blocs may vary from region to region and from country to country. The following motivations seem to play a key role in the formation of trading blocs :-

(i) To obtain economic benefits from achieving a more efficient production structure by exploiting economies of scale through spreading fixed costs over larger regional markets, increased economic growth from foreign direct investment, learning from experience, etc.

(ii) To pursue non-economic objectives such as strengthening political ties and manage migration flows.

(iii) To ensure increased security of market access for smaller countries by forming regional trading blocs with larger countries.

(iv) To improve the bargaining strength of members in the multilateral trade negotiations or to protest against the slow pace of trade negotiations.

(v) To promote regional infant industries which cannot be viable without a protected regional market.

(vi) Finally, to prevent further damage to their trading strength due to further trade diversion from third countries.

Regional integration schemes tend to increase intra-regional trade. There has, in fact, been a fast growth of the intra-regional trade. Economic integration schemes are thus an important part of the international business environment. There has been a significant growth of regional economic integration schemes designed to achieve various economic, social and political purpose. Most countries in the world are members of - or discussing participation in - one or more trade bloc known as Regional Integration Agreement/Arrangement (RIA).

More than half of world trade now occurs within actual or prospective trading blocs. In fact, many countries belong to more than one RIA. In march 2003, only four WTO members - Hong Kong, Macao, Mangolia and Chinese Taipei - were not party to a RIA. Thus, economic integration scheme are conceived as building blocks of economic development of the member countries.

7.16 Key Words

- **Economic Integration** : It is the effort to unite forces of two or more countries or regions for economic benefits. Geographic proximity is an important reason for economic integration.
- **Static Effects of Integration** - The shifting of resources from inefficient to efficient companies as trade barriers fall.
- **Dynamic Effects of Integration** - The overall growth in the market and the impact on a company caused by expanding production and by the company's ability to achieve greater economies of scale.
- **Trade Creation** - Production shifts to more efficient producers for reasons of comparative advantage, allowing consumers access to more goods at a lower price than would have been possible without integration.
- **Trade Diversion** - Trade shifts to countries in the regional trade group at the expense of trade with countries not in the group.
- **Economies of Scale** - The cost per unit falls as the number of units produced as the number of units produced rises; occurs in regional integration because of the growth in the market size.
- **The Single European Act** : It was designed to eliminate the remaining nontariff barriers to trade in Europe. In spite of significant progress, there are still barriers to trade that need to be eliminated.
- **The European Court of Justice** : It ensures consistent interpretation and application of EU treaties.
- **The European Council or European Summit** : It comprises of the heads of state and government of each member country.
- **Business Centre**- Business centre refers to a city or its put that is dedicated to comercial activity. it facilitates business meeting and talks.
- **Business Park** is an area of land in which many office buildings are grouped togather.
- **ASEAN - Association of South East Asian Nations** : It is a relatively successful free trade area in Southeast Asia that relies more on the U.S. market for exports than on each other.
- **EFTA - European Free Trade Associaton** - It is a trade Association that includes liechtenstein, Iceland, Norway and Switezerland and operates parrallel to and is linked to the European Union.
- **LAIA - Latin American Integration Association** - It attempts to create economic integration in Latin America and aims to create a free trade zone in Latin America.
- **SAARC - South Asian Association for Regional Cooperation** - It inclues seven South Asian countries seeking regional cooperation and acceleration of economic and social development.
- **ESCAP - Economic and Social Commission for Asia and the Pacific**, is the regional arm of the United Nations secretariat for Asia and the Pacific Region.

- **APEC- Asia Pacific Economic Coorporation** : It comprises of 21 countries that border the Pacific Rim; progress toward free trade is hampered by the size of APEC and the geographic distance between member countries.

- **MERCOSUR- The South Cone Common Market** : It is a customs union between Brazil, Uruguay, Paraguay, and Argentina. It has been slow in developing a common external tariff, and economic problems of meber countries have hampered progress.

- **ANCOM - Andean Common Market** - The second most important regional group in South America after MERCOSUR.

7.17 Self Assessment Test

1 Explain the concept of Economic Integration. What is the impact of Economic Integration on World Trade ?

2 What are the various types of Economic Integration ? Discuss.

3 'The European Union is the largest regional trade group'. Discuss the formation, organization structure and purpose of the EU.

4 What is the NAFTA ? Why was it formed ? Discuss its purpose and importance.

5 Have the Latin American Nations been able to achieve regional cooperation in trade ? Discuss the LAIA and ANCOM and their prupose to illustrate your answer.

6 What are the various regional trading groups in Asia and how successful have they been in improving trade in the region ?

7 What are the implications of Trade Blocks for Business ?

8. Examine the rational and scope of south-south cooperation.

9. Examine the objective progress and problems of E.U.

10. Name the important international trade agreements at Regional level.

11. Write a note on ASEAN or NAFTA.

12. Examine the advantage and disadvantage ao Regional Trade block.

13. What is SAPTA?

14. Write a note on ESCPE or SAPTA.

15. Describe objectives principles of SAARC.

7.18 References

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Unit - 8 : Global Strategic Management

Unit Structure:

8.0 Objectives

After studying this unit you will be able:

- To understand the concept of strategic management in global dimension.
- To understand the basic concept of value creation in global context
- To get acquainted with the process of global strategic management.
- To understand the various collaborative arrangements which facilitates a company to operate internationally.
- To discuss the role of ethics in global business.

8.1 Introduction

Global Strategic Management, distinct of domestic strategic management, is a sub-study of the wider concept of strategic management. Before we proceed to the concept of Global Strategic Management let us first understand strategic management. "Strategic management is the process of setting long-term direction for the organization." The central thrust of strategic management is achieving a sustainable competitive advantage. The term 'advantage' refers to the superior benefit, or superior position or condition, resulting from a course of action taken by the firm. 'Competitive' refers to a position in relation to an actual or potential rival. Finally, 'sustain' means to keep up a position over a long period of time. A sustainable competitive advantage is therefore the prolonged benefit gained from developing and implementing some unique value-adding strategy that is not simultaneously (or shortly thereafter) being imitated by current or potential rivals.

8.2 Global Strategic Management

Global Strategic management derives its meaning from the concept of strategic management with global dimensions. The three dimensions of Global Strategy may be discussed as follows:

a. **Coordination and Configuration:** According to this dimension global strategy is the process of exploiting the synergies that exist across different countries, as well as the comparative advantages offered by different countries (ZOU and Cavusgil 2002). According to this concept, companies operating globally must configure their activities to reap the benefits offered by different strategic locations. The companies should also have a proper framework to coordinate the activities across the countries to capture synergies derived from economies of scale.

b. **Standardization:** This dimension expressed by Levit(1983) defines global strategic management as a process of offering products across the countries.

c. **Integration:** According to this view, global strategy is concerned with the integration of competitive moves across country markets

Taking all the above dimensions together, Global Strategic Management may be defined as "A process of crafting a coherent, coordinated and unified strategy that sets the degree to which a firm globalizes its strategic behaviors in different countries through standardization of offerings, configuration and coordination of activities in different countries and integration of competitive moves across countries".

8.3 Value Creation

In today's competitive environment, value creation lays its foundation in the ability of the companyto envisage the ever increasing expectations of its customer base. Precisely, value creation is a function of customers, employees and investors satisfaction. In order to create a sustainable value all the three groups should be satisfied. The prime consideration for any business is the customer, but customer cannot be satisfied until and unless the firm possesses employees who are well trained and efficient and unless investors receive consistent and attractive returns.

8.3.1 Strategies for Creating Value in Global Context:

(1) Adaptation:

Adaptation strategies involve adjusting the business model according to the taste and preferences of the local market. This strategy is necessary virtually for all products. Companies adopt various approaches to adapt their products and services to the need of local market like :

- **Variation:** It involves making changes in products, services , policies and positioning to adapt to the local environment.
- **Focus:** It includes concentrating on specific stages of the value chain or market segments to reduce impact across regions.
- **Externalization:** This approach involves transferring responsibility for a part of a company's business to partner companies in order to accommodate to the local requirements or to reduce the cost or diversify the risk.
- **Design:** This approach involves modulating the design of the product, so as to make it cost effective and within the affordable range of target customers.
- **Innovation:** This approach involves bringing innovations in the existing product range or addition to the existing product portfolio so as to improve the effectiveness of adaptation endeavors.

(2) Aggregation:

Aggregation strategies involves creating economies of scale to exploit similarities, without jeopardizing local responsiveness. Companies adopt various approaches to create economies of scale:

- **Economic:** Companies adopt various strategies to allocate resources and in investment decisions based on the nature of economy. Like companies distinguish between the developed and developing markets and choose to focus on one or the other.

- **Geographic:** It involves focusing competitive interactions on a regional or global level. Example a firm centralizes its global production at few strategic locations.
- **Cultural:** Cultural aggregation involves achieving cost advantage by identifying the cultural similarities. Like Books having international demand are published only in few languages as the publishers know that the readers will be willing to read the book even in the second language.
- **Administrative:** Administrative aggregation involves achieving economies of scale by identifying the similar or common legal/administrative requirements of a group of target region and taking advantage of the same. Like companies looking to market new drugs in European region must meet the regulatory norms of few elected countries to qualify for the license to sell them thought Europe.

(3) Arbitrage:

Arbitrage strategies aims at creating value through identifying mispricing between the similar products and services in two or more regions. It thus involves exploiting the differences between markets instead of trying to adapt to them. Arbitrage approaches may be discussed as follows:

(a) Economic: If certain factors of production are available at a lower cost in some another region/ country, company may take advantage by outsourcing the work at a lower cost as compared to the cost of accomplishing the same work locally.

(b) Geographic: advancement of technology has led to value creation by enabling collaborations across different geographic regions. Like Doctors in the US take X-Rays during the day and send them to Indian doctors for interpretation overnight. The next day morning reports are available in US. Similarly arbitrage strategies may be adopted to create value by taking advantage of cultural and administrative differences.

The question which now arises is that which strategy company should use to create value. No one strategy is best suited in all the circumstances. Leading and successful companies have implemented all the three strategies at one or the other point of time. Effective implementation of these strategies calls for stretching the managerial abilities and competitive efficiency.

8.4 Process of Global Strategic Management

Businesses today operate round the world and are not limited to a distinct territory. In this modern, global competitive environment it is imperative for managers to understand the global strategic management process. Knowing this process will enable managers to select the suitable market and frame suitable entry strategies develop the business in these new markets and to continually manage and develop the business globally. The process of global strategic management may thus be discussed as follows:

1. **Selecting Foreign Markets:** Strong foundation leads to success for sure. The substance of global strategic management lies in selecting the right and appropriate markets to enter into. Various factors should be considered while choosing a market, most important being the market dimension (size and magnitude), the market forte (strength and specialty) and proximity to local resources (including natural resources, capital resources and human resources). Managers should also take into account the cross cultural and economic differences, geographic and administrative distances between countries as large distances can lead to further complications in operating business.
2. **Entering Markets:** A vigilant manager is highly tactical in his market entry strategy. One of the following strategies may be adopted to make an entry in the market:
   - To open a wholly owned subsidiary.
   - Local acquisition or merger.

The first option places a foreign firm at considerable disadvantage, because it implies that the firm has to adapt itself to the local market without much local acquaintance. Healthier options for gaining local knowledge, includes entering via the latter strategy of local acquisition or merger, which gives the firm access to local employees and knowledge.

3. **Building the Firm:** Survival of the firm after making an entry in a market depends upon the effectiveness of the strategic plan for growth of the company. The strategic planning involves achieving the various objectives like:

   - Building the local reputation and market share,
   - Building local competencies. Local competencies are based on the locally available resources. For example, growth of BPO industry in India.

4. **Continuous Management:** Continuous growth and development is an important part of the global strategic management process. Managers must continually monitor the market to determine if the market is still appropriate and if the firm is properly positioned in the market. When the market fluctuates or become unfavorable, business must either adapt to the local changes. Another strategy may be, in drastic cases, to exit the market altogether and search for some another strategic location.

5. **Collaborative Strategies:** "Collaborative Strategy is the synergy between the strategy of a Business and the Strategy of its Partners to realize the objectives through collaboration." The concept is being used by the companies as a growth strategy wherein companies collaborate with their partners, vendors, customers etc., to create synergy at strategic level to expand their business. Classic example of Collaborative Strategy is the business models of Procter & Gamble to collaborate with numerous researchers across the globe. Also, Bharti Airtel, the telecom giant of India achieved phenomenal growth adoption Collaborative Strategy with their vendors like IBM, Ericsson, Nokia etc.

Need for collaborative strategies:

Global Expansion of business exposes firm to a variety of country environments, which further calls for designing and implementing effective strategies to manage the cross country issues. When forming objectives and implementing strategies to handle the international business, the firm has to decide whether it will handle the overseas operations on its own or collaborate with the other companies (Local or Foreign). An alternative available to the above strategy is to export as it allows firms to produce within their local boundaries. Operating in some markets may also require use of a variety of other equity and non equity arrangements which may be in the form of wholly owned operations to partially owned subsidiaries, joint ventures, equity alliances, licensing, franchising, management contracts, and turnkey operations.

Companies may find more advantages by producing in foreign countries rather than by exporting to them due to a variety of reasons as under:

i. **Cost Advantage:** Cost is one of the most crucial factors to be considered while dealing in the competitive environment. Competition necessitates companies to control their costs and to select production sites keeping this factor into view.

ii. **Intermediary Costs:** Intermediary cost like transportation cost, tariffs etc makes the exports uncompetitive for certain products and services. If the target market is too distant, the increased transportation cost may render the product uncompetitive in the market. Further,some services nearly impossible to export and therefore, require launching operations in the target market.

iii. **Capacity Constraints:** If the production capacity of a firm is in excess of the domestic demand and is able to recover its total cost from its domestic sales, it can export its products to the foreign market at the marginal cost rather than the average cost. It increases the overall profitability. But when total demand exceeds the capacity, new facilities are required. The new facilities should be strategically located ie. nearer to the end consumers in other countries.

iv. **Customization of Products and Services:** Special requirements for products in the target country demands for additional investments at the places, where the products or services are intended to be sold. Higher is the degree of customization, greater are the chances of shifting the production to the foreign markets.

- **Types of Collaborative Arrangements:**

The most crucial variables which influence the choice of collaborative arrangements are the firm's desire to control its foreign operations and its prior expansion into previous ventures. In case of collaborative arrangements chances are there that the firm may lose control over decisions pertaining to quality and product expansion. Similarly, if a firm already owns and operates internationally collaboration may not be as attractive as otherwise. Firm has variety of options available for entering into a collaborative arrangement. Some of them may be discussed as follows:

A. Licensing:

Under a licensing agreement, a firm (the licensor) grants rights to intangible property to another company (the licensee) to use in a specified geographic area for a specified period of time; in exchange, the licensee ordinarily pays a royalty to the licensor. Such rights may be exclusive or nonexclusive. Usually the licensor is obliged to furnish technical information and assistance, while the licensee is obliged to exploit the rights effectively and pay compensation to the licensor. Intangible property may be classified as:

- Patents, inventions, formulas, processes, designs, patterns
- Copyrights for literary, musical, or artistic compositions
- Trademarks, trade names, brand names
- Franchises, licenses, contracts
- Methods, programs, procedures, systems.

Licensing often has an economic motive, such as the desire for faster start-up, lower costs, or access to additional property rights (e.g., technology). For the licensor, the risks and costs of a given venture are lessened; for the licensee, costs are less than if it had to develop a product or process on its own. *Cross-licensing* represents the situation in which companies in various countries exchange technology rather than compete with each other with every product in every market. The amount and type of payment for licensing arrangements may vary. Each contract tends to be negotiated on its own merits; the bargaining range is based on dual expectations. Both agreement-specific and environment-specific factors may affect the value of a license.

Many licenses are given to firms owned in part or in whole by the licensor. From a legal standpoint, subsidiaries are separate companies; thus, a license may be required in order to transfer intangible property.

B. Franchising:

Franchising represents a specialized form of licensing in which the franchisor not only sells an independent franchisee the use of the intangible property essential to the franchisee's business, but also operationally assists the business on a continuing basis. In a sense, the two partners act like a vertically integrated firm because they are interdependent and each produces a part of the product that ultimately reaches the customer.

- **Organization of Franchising.** A franchisor may penetrate a foreign country by dealing directly with its foreign franchisees, or by setting up a master franchise and giving that organization the right to open outlets on its own or to develop sub-franchises in the country or region.
- **Operational Modifications.** Franchise success is derived from three factors: product standardization, effective cost control and high recognition. Nonetheless, franchisors face a classic dilemma: the more they standardize on a global basis, the lower the potential for product acceptance in a given country; the more they permit adaptation to local conditions, the less the franchisor can offer the franchisee, the higher the costs and the less the control by the franchisor.

C. Management Contracts:

A management contract represents an arrangement in which one firm provides management personnel to perform general or specialized functions to another firm for a fee. A firm usually pursues such contracts when it believes a partner can manage certain operations more efficiently and effectively than it can itself.

D. Turnkey Operations:

Turnkey operations represent a type of collaborative arrangement in which one firm contracts with another to build complete, ready-to-operate facilities. Usually, suppliers of turnkey facilities are industrial-equipment and construction companies; projects may cost billions of dollars; customers most often are government agencies or large MNEs.

F. Joint Ventures:

A joint venture represents a direct investment in which two or more partners share ownership. As a firm's share of the equity declines, its ability to control a given operation also declines. A **consortium** represents the joining together of several entities (e.g., companies and governments) to combine resources and/or to strengthen the possibility of pursuing a major undertaking. Other forms of *joint ventures* include:

- Two companies from the same country joining together in a foreign market, such as NEC and Mitsubishi (Japan) in the United Kingdom
- A foreign company joining with a local company, such as Great Lakes Chemical (U.S.) and A. H. Al Zamil in Saudi Arabia
- Companies from two or more countries establishing a joint venture in a third country, such as that of Diamond Shamrock (U.S.) and Sol Petroleo (Argentina) in Bolivia
- A private company and a local government forming a joint venture (sometimes called a mixed venture), such as that of Philips (Dutch) with the Indonesian government
- A private company joining a government-owned company in a third country, such as BP Amoco (private British-U.S.) and Eni (government-owned Italian) in Egypt

G. Equity Alliances:

An **equity alliance** represents a collaborative arrangement in which at least one of the collaborating firms takes an ownership position (usually a minority) in the other(s). The purpose of an equity alliance is to solidify a collaborating contract, thus making it more difficult to break. Each participant in a collaborative arrangement has its own basic objectives for operating internationally as well as its own motives like cost reduction, gaining competitive advantage, counter competition etc. for collaborating with a partner.

International drivers to the collaborative strategies may be discussed as follows:

1. **Gain Location-Specific Assets.** Cultural, political, competitive, and economic differences among countries create challenges for companies that operate abroad. To overcome such barriers and gain access to location-specific assets (e.g., distribution access or a competent workforce), firms may pursue collaborative arrangements.

2. **Overcome Governmental Constraints.** Countries may prohibit or limit the participation of foreign firms in certain industries, or discriminate against foreign firms via tax rates and profit repatriation. Firms may be able to overcome such barriers via collaboration with a local partner.

3. **Diversify Geographically.** By operating in a variety of countries, a firm can smooth its sales and earnings; collaborative arrangements may also offer a faster initial means of entering multiple markets or establishing multiple sources of supply.

4. **Minimize Exposure in Risky Environments.** The higher the risk managers perceive with respect to a foreign operation, the greater their desire to form a collaborative arrangement.

- **Negative side of Collaborative Arrangements**

Dissatisfaction with the results of collaboration can cause an arrangement to break down. Problems arise for a number of reasons.

A. **Lack of Compatibility Between the Partners:** One partner may give more attention to the collaboration than the other—often because of a difference in size. An active partner will blame the less active partner for its lack of attention, while the less active partner will blame the other for poor decisions.

B. **Divergent Objectives:** Although firms may enter into collaborative arrangements with complementary capabilities and objectives, their views regarding such things as reinvestment vs. profit repatriation and desirable performance standards may evolve quite differently over time.

C. **Problem of Control:** When no single party has control of a collaborative arrangement, the venture may lack direction; if one party dominates, it must still consider the interests of the other. By sharing assets with another firm, a company may lose some control over the extent and/or quality of the assets' use. Further, even when control is ceded to one of the partners, both may be held responsible for problems.

D. **Cultural Differences:** Differences in both national and corporate cultures may cause problems with collaborative arrangements, especially joint ventures. Firms differ by nationality in terms of how they evaluate the success of an operation (e.g., profitability, strategic market position and/or social objectives). Nonetheless, joint ventures from culturally distinet countries tend to survive at least as well as those between partners from similar cultures.

8.5 Ethics in Global Business

Marjaana Kopperi (2007) views business ethics simply in terms of social and ecological responsibility of business. Business ethics emphasizes that the decision pertaining to business should not be exclusively based upon narrow monetary perspectives, but social and ecological concerns should be taken into account. It thus means that the interest of all the stakeholders should be duly acknowledged and given proper weightage.

Global Business Ethics are characterized by following considerations:

- Ethical principles are not unique. Every country has a set of own values, customs and traditions which have a deep routed history. In the course of time they have developed their own ethical

values and acceptance of ethical principles;
- Absence of Global ethical code of conduct.
- Lack of initiative on part of government to create ethical support framework to promote ethical behavior in global business;

Levels of Business Ethics:

1. Macro Level (National – Global relationships and role of business on an international scale)
2. Corporate Level (Corporate Social Responsibility)
3. Individual Level (Behavior and actions of individuals within the organization)

• It is hard to outline those ethical values which would be understandable, acceptable and important for representatives of all the continents simultaneously within different types of international cooperation projects.

D V R Seshadri, Achal Raghavan, and Shobitha Hegde (2007) suggests that it makes good long-term business sense to be ethical.

For a company's ethics policy to be successfully implemented, it is essential that:

- The code of ethics is clearly communicated to employees.
- Employees are formally trained in it. They are told how to deal with ethical challenges.
- The code is implemented strongly.
- The code is contemporary.
- The company leadership adheres to the highest ethical standards.

Advantages of following business ethics:

- Higher revenues – demand from positive consumer support
- Improved brand and business awareness and recognition
- Better employee motivation and recruitment
- New sources of finance – e.g. from ethical investors

8.6 Summary

Global Strategic Management, distinct of domestic strategic management, is a sub-study of the wider concept of strategic management. Here are three dimensions of global strategy namely, Coordination and Configuration, Standardization and Integration. Value creation is a function of customers, employees and investors satisfaction. In order to create a sustainable value all three groups should be satisfied. Three are three strategies for value creation in global context namely: Adaptation, Aggregation and Arbitrage. The global strategic management process includes following important elements: selection of market, entry strategy, firm building and Continuous Management. Licensing, Franchising, Management Contracts, Turnkey Operations, Joint Ventures, Equity Alliances etc are some of the collaborative arrangements common in global business.

8.8 Key Words

- **Adaptation:** Adaptation strategies involve adjusting the business model as per requirement of the market.
- **Aggregation:** It involves creating economics of scale
- **Arbitrage:** It involves creating values.
- **Joint Venture:** Two or more partners share ownership of a firm.

8.7 Self Assessment Test

1. Discuss the dimensions of global strategic management.
2. Explain why some industries are more global than others.
3. Explain the strategies of value creation in global context.
4. Discuss the process of global strategic management.
5. Discuss why exports are not preferred over collaborative arrangements?
6. Explain some of the collaborative strategies taking examples from indian industry.
7. Explain the role of ethics in global business.

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Unit - 9: International Finance and Foreign Exchange

Unit Structure:

9.0 Objectives

After studying this unit you will be able:

- To understand the meaning and scope of international finance.
- To understand the mechanics of international financial environment
- To understand the concept of foreign exchange markets.
- To gain the understanding of the foreign exchange rates.
- To study the convertibility of rupee and its implications to Indian economy.
- To understand the role of foreign institutional investment in Indian economy.
- To study international financial market instruments.
- To understand the application of capital budgeting techniques in case of multinational firms.
- To understand the capital structure and cost of capital of multinational firms.

9.1 Introduction

The expansion of international business has increased the flow of finance. While the private financial flow are generally guided by commercial objective, financial flow related to official development assistance (ODA) have also implications for business. In this unit we shall discuss the meaning and scope of international finance and the international financial environment. International capital flows are substantially impacting the business environment. There are two types of foreign investment in a country: FDI and FPI. FDI (Foreign Direct Investment) refer to investment in a foreign country where the investor retains control over the investment. FPI (Foreign Portfolio Investment) refers to buying equities bonds or other securities abroad. FDI are governed by long-term consideration where a FPI are governed by short-run objectives. Foreign trade and FDI are mutually influential international investment is influenced by a number of factors such as: macro economic policy, governance, market perfections, government rules,infrastructure currency market and strong local currency remittances out of the country and a favorable tax climate. In this unit we will discuss the foreign exchange rate and international capital budgeting. In the end we will present summary of the chapter, key words self assessment test and references.

9.2 International Finance

International finance is the sub area of economics that encompasses the foreign investment, global financial system, vibrancy of exchange rates, and their impact on international trade operations and relations. International finance also covers the areas related to international projects, international investments and capital flows, and trade deficits. It also includes the study of volatility in international trade and the measures to provide a cover to the risk exposures. It thus includes the study of futures, options, currency swaps and other complex derivative instruments.

The importance of multinational corporations and the globalization of production are now well recognized. Multinational corporations have become central actors of the world economy and, in linking foreign direct investment, trade, technology and finance; they are a driving force of economic growth. Since the world is reduced to an electronic village and global finance has become a reality, therefore in a contemporary global corporation financial capital is one of the most fungible assets to cross national boundaries. The determinants of the way in which transnational corporation acquire, organize and manage those assets is of critical importance, not only to the success of those corporations, but also to the development and industrial restructuring of nation states. The task of international financial manager is to make the best possible tactical decision that the market has to offer on liabilities, within the strategic funding constraints set by currency denomination, maturity, and capital structure.

9.3 International Financial Environment

India has commercial and financial relations with almost all the foreign countries. These relations results in the trade – import and export of goods and services and financial flows. Trade relations result into inflow and outflow of funds into and outside the country respectively. Movement of short term funds takes place to finance trade or for working capital requirement or as unilateral transfers etc. Speculative flows are also possible although not in India to take an advantage of the differential in interest rates or exchange rates. If the funds are moving in and out of the country for investment purpose, they may take the form of investment in working capital. The capital flows may also take place on account of consultancy services or in projects etc. The capital flow thus contributes to trade relations. Therefore trade is an important constituent of international financial/ economic relations and assumes eminent position in the study of international finance. Apart from trade there are other components of the international financial system which together form the international financial environment.

International financial system relates to the management of and trading in international money and monetary assets. These monetary assets are claims on foreign currency, foreign deposits and investments. The claims may be denominated in various foreign currencies purchased and sold and involves exchange between various currencies. These transactions thus give rise to:

- Borrowing and lending operations in foreign currencies / Trading in financial assets denominated in foreign currencies
- Foreign exchange transaction involving an exchange of one currency for another.

The former type of transactions is the part of foreign currency market and the later forms the part of foreign exchange market.

9.3.1 International Currency Markets

These are the markets where internationally accepted currencies (reserve currencies) are traded. It includes the deposits of such currencies with international banks at an agreed rate of interest. The countries, institutions and governments having surplus of reserves, lent the excess funds to the banks and other financial institutions for various durations at a rate of interest. The currencies are in demand for meeting the balance of payments deficit or for investment in fixed capital or for working capital purposes. The borrowing and lending for short term constitute the international money markets.

9.3.2 Foreign Exchange Market

The market for foreign exchange involves the purchase and sale of national currencies. A foreign exchange market exists because economies employ national currencies. If the world economy used a single currency there would be no need for foreign exchange markets. In Europe 11 economies have chosen to trade their individual currencies for a common currency. But the euro will still trade against other world currencies. For now, the foreign exchange market is a fact of life. The foreign exchange market is extremely active. It is primarily an over the counter market, the exchanges trade futures and option (more below) but most transactions are OTC. It is difficult to assess the actual size of the foreign exchange market because it is traded in many markets.

Globally, operations in the foreign exchange market started in a major way after the breakdown of the Bretton Woods system in 1971, which also marked the beginning of floating exchange rate regimes in several countries. Over the years, the foreign exchange market has emerged as the largest market in the world. The decade of the 1990s witnessed a perceptible policy shift in many emerging markets towards reorientation of their financial markets in terms of new products and instruments, development of institutional and market infrastructure and realignment of regulatory structure consistent with the liberalized operational framework. The changing contours were mirrored in a rapid expansion of foreign exchange market in terms of participants, transaction volumes, decline in transaction costs and more efficient mechanisms of risk transfer.

The foreign exchange market in India started in earnest less than three decades ago when in 1978 the government allowed banks to trade foreign exchange with one another. However, it was in the 1990s that the Indian foreign exchange market witnessed far reaching changes along with the shifts in the currency regime in India. The exchange rate of the rupee, that was pegged earlier was floated partially in March 1992 and fully in March 1993 following the recommendations of the Report of the High Level Committee on Balance of Payments (Chairman: Dr.C Rangarajan). The unification of the exchange rate was instrumental in developing a market-determined exchange rate of the rupee. Today over 70% of the trading in foreign exchange continues to take place in the inter-bank market. The market consists of over Authorized Dealers (mostly banks) who transact currency among themselves and come out "square" or without exposure at the end of the trading day. Trading is regulated by the Foreign Exchange Dealers Association of India (FEDAI), a self regulatory association of dealers. Since 2001, clearing and settlement functions in the foreign exchange market are largely carried out by the Clearing Corporation of India Limited (CCIL). The liberalization process has significantly boosted the foreign exchange market in the country by allowing both banks and corporations greater flexibility in holding and trading foreign currencies. The Sodhani Committee set up in 1994 recommended greater freedom to Participating banks, allowing them to fix their own trading limits, interest rates on deposits and the use of derivative products.

The two main functions of the foreign exchange market are to determine the price of the different currencies in terms of one another and to transfer currency risk from more risk-averse participants to those more willing to bear it. As in any market essentially the demand and supply for a particular currency at any specific point in time determines its price (exchange rate) at that point. However, since the value of a country's currency has significant bearing on its economy, foreign exchange markets frequently witness government intervention in one form or another, to maintain the value of a currency at or near its "desired" level. Interventions can range from quantitative restrictions on trade and cross-border transfer of capital to periodic trades by the central bank of the country or its allies and agents so as to move the exchange rate in the desired direction. It is safe to say that over the years since liberalization, India has allowed restricted capital mobility and followed a "managed float" type exchange rate policy. The main sources of foreign exchange are export earnings from goods and services, remittances from overseas, direct investment flows and private and official loan inflows. The owners of these receipts are the fundamental suppliers in the market, that is, they sell foreign exchange to licensed foreign exchange dealers who are then able to sell to other institutions and individuals who need to buy foreign exchange. The other components of the international financial system are international capital markets and bond markets.

9.3.3 Institutions in International Financial System

There are a number of institutions who are part of international financial system. These institutions may be classified into following categories:

i. National banks and domestic financial institutions which are authorized to deal in foreign currencies and foreign credits.

ii. International brokers and security firms of repute.

iii. Regional and multinational banks or companies dealing in international markets.

iv. Regional Finance and Development Corporations and banks such as the Asian Development Bank, Commonwealth Finance Corporations, Latin American Development bank etc.

v. International Financial Organizations such as International monetary Fund (IMF), International Bank for Reconstruction and Development (IBRD), International Finance Corporation(IFC), and International Development Agency (IDA).

9.4. Foreign Exchange Rate

Foreign exchange rate is the value at which a country's currency unit is exchanged for another country's currency unit. For example, the current foreign exchange rate for Euros is: 100 EUR = USD 130. Currently, domestic banks will determine their exchange rates based on international financial markets. There are two common ways to quote exchange rates, direct and indirect quotation.

1. Direct Quotation: This is also known as price quotation. It is usually expressed as the amount of domestic currency that can be exchanged for 1 unit or 100 units of a foreign currency. The more valuable the domestic currency, the smaller the amount of domestic currency needed to exchange for a foreign currency unit and this gives a lower exchange rate. When the domestic currency becomes less valuable, a greater amount is needed to exchange for a foreign currency unit and the exchange rate becomes higher. Under the direct quotation, the variation of the exchange rates are inversely related to the changes in the value of the domestic currency. When the value of the domestic currency rises, the exchange rates fall; and when the value of the domestic currency falls, the exchange rates rise. For example, the price of one INR is \$ 0.02102607. It can be written as US\$ 0.02102607/INR.

2. Indirect Quotation: This is also known as the quantity quotation. The exchange rate of a foreign currency is expressed as equivalent to a certain number of units of the domestic currency. This is usually expressed as the amount of foreign currency needed to exchange for 1 unit or 100 units of domestic currency. The more valuable the domestic currency, the greater the amount of foreign currency it can exchange for and the lower the exchange rate. When the domestic currency becomes less valuable, it can exchange for a smaller amount of foreign currency and the exchange rate drops. Under indirect quotation, the rise and fall of exchange rates are directly related to the changes in value of the domestic currency. When the value of the domestic currency rises, the exchange rates also rise; and when the value of the domestic currency falls, the exchange rates fall as well.

Direct Quotation	**Indirect Quotation**
USD/JPY = 134.56/61	EUR/USD = 0.8750/55
USD/HKD = 7.7940/50	GBP/USD = 1.4143/50
USD/CHF = 1.1580/90	AUD/USD = 0.5102/09

There are two implications for the above quotations:

(1) Currency A/Currency B means the units of Currency B needed to exchange for 1 unit of Currency A.

(2) Value A/Value B refers to the quoted buy price and sell price. Since the difference between the buy price and sell price is not large, only the last 2 digits of the sell price are shown. The two digits in front are the same as the buy price.

3. Cross Rate: A cross rate is the currency exchange rate expressed by a currency pair in which none of the currencies involved is the official currency of the country in which this quotation is made. For example, if the currency exchange rate between a Japanese yen and a British pound is quoted in a United States newspaper, this would be called a cross rate since none of the currencies of this pair is the US dollar. However, if the same rate is quoted in a Japanese newspaper, it would not be a cross rate, since Japan's official currency is involved in this pair.

At a more general level, the exchange rates expressed by any currency pair that does not involve the US dollar are called cross rates. Thus, this broader definition implies that the exchange rate of the currency pair GBP/JPY would be a cross rate, regardless of the country in which this quotation is being made.

9.5. Capital Account Convertibility

The term Capital Account Convertibility (CAC), means relaxing controls on capital account transactions. The control may be imposed in any of the following ways:

- Quantitative restriction on capital movement
- Multiple exchange rate system

In the process of transition from the controlled rate regime to a market determined regime, CAC is one of the concluding phase step. The basic question that arises is whether the monetary authorities should go for CAC. The advocates of capital control are of the view that control has three basic advantages (Mathieson and Rojas- Suarez, 1993):

1. It reduces the instability of exchange rates in the period of volatility and unstiffens the balance of payment crises.
2. It ensures that the investments are financed through domestic savings and thus avoids the foreign ownership of domestic factors of production.
3. It helps in maintaining the authorities' ability to tax domestic financial activities.

But, the experience of capital control measures in developed as well as the developing nations shows that such measures have not been very effective. If the capital controls become less rigid, inefficiencies are created in the domestic financial system that hinders risk diversification that in turn weakens the competitive position of exports and results in domestic financial shocks. If the control mechanism are tightened further to ensure its efficacy, further distortions are created in the economy. The licenses granting capital account transactions are sold at premium in the market. Quirk and Evans (1995) and Cooper(1998) argued for capital account liberalization. Under liberalization, the day to day approvals from monetary authorities are not required for capital account transactions. This stimulates the economic growth. Capital account liberalization opens the gate for domestic financial markets to integrate with the foreign financial markets; as a result economy is able to avail of large amount of external resources.

Implications of Convertibility of Rupee:

1. The government, in a fully convertible regime, will not be able to control these flows directly. Indirectly controls will be implemented by changing interest rates and taxes but the effectiveness of this control according to the international experiences are uncertain.
2. Foreigners would be able to invest in the Indian stock markets, buy up companies and property including land (unless there are restrictions). Indian people and companies can import anything they would like, buy shares of foreign companies and property in foreign lands and can transfer money as they please without going through the Hawala business. Indians those who have not paid their taxes or repaid their loans taken from the Indian banks will be free to transfer their money to foreign countries outside the jurisdiction of the Indian authority. Implications are very serious indeed.
3. The expected benefits for India would depend on the attractiveness of the country as a safe destination for short-term investments. Long-term investments do not depend on convertibility. China has no convertibility, instead a fixed exchange rate for the last 12 years. Yet, China is the most important destination for long-term foreign investments. Thus, discussions about the full convertibility should be about the desirability of short-term investments and their implications.
4. Short term investments i.e., foreign investments in shares and bonds of the Indian companies and India government depend on the demonstration of profit of the Indian companies and the continuous good health of the Indian economy in terms of low budget deficits, low balance of payments deficits, low level of government borrowings, low level of non-performing loan in the Indian banking system. From these points of view India cannot be a very attractive destination as the health of the economy
5. If there is any sign of economic downturn when there is a fully convertible Rupee. The results will be further increase in the balance of payments deficits and fall of the exchange rate of Rupee, which will provoke Indians to take their money out of India.

6. The most dangerous consequence of convertibility is that Rupee will be under the control of currency speculators. A fully convertible regime for the Rupee will certainly include participation of Rupee in the international currency market and in the 'future market' of Rupee, the playground for the international speculators. It is very much possible for the speculators to buy massive amount of Rupee to drive up its exchange rate and then they can suddenly sell all to gain enormous profit. That will drive down Rupee to a very low depth suddenly. If the Reserve Bank of India wants to protect Rupee in such a situation, within a few days India will have no foreign exchange left in reserve and the country will go bankrupt. Similar situation took place in 1998 for South Korea, Thailand, and Indonesia, all with then convertible currency. Malaysia has survived by imposing fixed exchange rate, exchange control, and making Malaysian dollar nonconvertible. Both India and China were unaffected because their economies at that time was closed and their currencies were non-convertible.

Capital account liberalization has its effect not only on the macro level but at the individual level also. The residents are able to hold internationally diversified portfolio of assets, which lessens the controllable risk of investment. The domestic providers of financial services become more efficient as a result of increased competition from abroad.

However, CAC cannot work out in the presence of domestic distortions. In the view of experiences from the developed and developing nations, Quirk and Evans(1995) discuss some preconditions for CAC. It should be a gradual process rather than one shot decision like in Mauritius, Singapore and Venezuela. It means that current account convertibility should precede CAC in order to make the latter workable.

9.6. Foreign Private Investment

There are two types of foreign investments as discussed below:

- **Foreign Direct Investment (FDI)**

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 a foreign country. FDI's are governed by long term considerations as they cannot be easily liquidated.

- **Foreign Portfolio Investment (FPI)**

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. Thus in portfolio investment, investor uses his capital to get a desired return but has no control over the use of capital. There are mainly two routes of foreign institutional investment:

- Foreign Institutional Investors (FIIs) like mutual funds, through Global Depository Receipts (GDRs). American Depository Receipts(ADRs) and
- Foreign Currency Convertible Debentures (FCCBs).

Since, the economic liberalization there has been a substantial increase in foreign investments in India. Table 9.1 shows the growing trend of FII's in India both in the equity and debt sector.

Table 9.1

FII Investment Details (Financial Year)

(in Rs/ Crores)

Financial Year	Equity	Debt	Total
1992-93	-	-	13.4
1993-94	-	-	5,126.5
1994-95	-	-	4,796.3
1995-96	-	-	6,942.0
1996-97	-	-	8,574.5
1997-98	5,267.0	691.1	5,957.2
1998-99	-717.2	-867.0	-1,584.0
1999-00	9,669.5	452.6	10,122.1
2000-01	10,206.7	-273.3	9,933.4
2001-02	8,072.2	690.4	8,762.6
2002-03	2,527.2	162.1	2,689.3
2003-04	39,959.7	5,805.0	45,764.7
2004-05	44,122.7	1,758.6	45,881.3
2005-06	48,800.5	-7,333.8	41,466.7
2006-07	25,235.7	5,604.7	30,840.4
2007-08	53,403.8	12,775.3	66,179.1
2008-09	-47,706.2	1,895.2	-45,811.0
2009-10	110,220.6	32,437.7	142,658.3
2010-11	110,120.8	36,317.3	146,438.1
2011-12 (till Aug31,)	2,367.6	8,186.2	10,553.8

Source: Report

9.6.1 International Equity / Euro Issues

International markets are an important source of fund raising in today's global environment. Sale ofsecurities, such as international equities or euro-equities, international bonds, medium term and short term euro notes and euro commercial papers are some of the instruments through which funds may be raised in international markets. International equity market began to grow in a big way after the debt crises of early 1980's. The use of securities is quite wide in recent days.International equities or the Euro-equities do not represent debt, nor do they represent the foreign direct investment. They represent the foreign portfolio equity investment.

Process of Issuing International Equity

While planning for the issue of international equity, company has to decide first decide about the size of the issue, market where the equities are to be issued, the issue price and the other related formalities. The company approaches the lead manager (investment bank). The lead manager examines the risk involved in the capital issue. When the lead manager gives the green signal, the issuing company prepares the prospectus, etc. and takes permission from the regulatory authorities.

After getting approval from the regulatory authorities, it deposits the shares to be issued with the custodian bank. The custodian bank then asks the depository located in a foreign country to issue depository receipts in lieu of the shares held. The ratio between the number of shares and the number of depository receipts (ADR's / GDR's) is decided well in advance before the actual issue.

The depository in the international market serves as a link between the issuing company and the investors. On getting information from the issuing company, the depository issues the depository receipts. The American depository issues American Depository Receipts (ADR), while the depositories in the international financial markets outside USA, issues Global Depository Receipts (GDR)

GDRs (Global Depository Receipts)

A global depository receipt or global depositary receipt (GDR) is a certificate issued by a depository bank, which purchases shares of foreign companies and deposits it on the account. GDRs represent ownership of an underlying number of shares. Global depository receipts facilitate trade of shares, and are commonly used to invest in companies from developing or emerging markets. Prices of global depositary receipt are often close to values of related shares, but they are traded and settled independently of the underlying share.

Several international banks issue GDRs, such as JPMorgan Chase, Citigroup, Deutsche Bank, Bank of New York. GDRs are often listed in the Frankfurt Stock Exchange, Luxembourg Stock Exchange and in the London Stock Exchange, where they are traded on the International Order Book (IOB). Normally 1 GDR = 10 Shares, but not always. It is negotiable instrument which is denominated in some freely convertible currency. It is a negotiable certificate denominated in us dollars which represents a NON-US Company's publicly traded local equity.

1. Voting Rights to the GDR holders

GDR investors keep on changing with time and they also do not seem to be very much interested in the voting rights, knowing the fact that the rights can not be denied to them.

There are different approaches followed in this respect:

- There is an agreement between the company and the overseas depository, which enables the depository to vote either with the majority voters or according to the wishes of the management.
- It is understood that the depository votes in the same proportion as the majority shareholders.
- Depository may vote in accordance with the instructions of the nominee of the management.

2. Cost of issuing international equity:

Cost of issuing international equity generally involves commission, management fee etc paid to the lead manager. It also includes some expenses incurred by the depository. These expenses taken together generally amounts to 3-4% of the issue amount.

9.7 International Capital Budgeting

The decision to invest abroad takes a concrete shape when a future project is evaluated in terms of value addition to the investing company. The evaluation of long term capital investment projects is known as capital budgeting. The technique of capital budgeting is similar to domestic as well as the international company with a difference that the complexities of foreign exchange and other related matters appear in case of international capital budgeting decisions. These complexities further affect the cash flow and the required rate of return.

1. Evaluation Criteria:

The methods to evaluate the international capital budgeting decisions , just like the domestic capital budgeting decisions, may be categorized into :

- Non –Discounting methods
- Discounting Methods

2. Non-Discounting Methods:

These methods do not take into consideration the time value of money while evaluating the project. Following non discounting techniques are generally used while evaluating the projects:

i. Payback Period

ii. Pay Back Reciprocal

iii. Average Accounting rate of Return

Pay Back period is the time horizon within which the initial investment is recovered. If the investment is not recovered within the payback period, the project should not be accepted. Thus, this method stresses on the early recovery of funds, but fails to consider the cash profitability after the pay back period.

Pay back reciprocal is the rate at which the initial investment is recovered. It is the reciprocal of pay back period. If the pay back period of a project is 5 years. The pay back reciprocal is 20% , which implies that the initial investment is recovered back at the rate of 20% per annum. The projects yielding high pay back reciprocals are accepted.

Average Accounting rate of Return represents the mean profit on account of investment prior to interest and tax payments. Mean profit is compared with the hurdle rate or required rate of return. The project is acceptable if the mean profit is higher than the hurdle rate. The major shortcoming of this method is that it is based upon the accounting income and not on the cash inflow. The Key disadvantage of all the non-discounting techniques is that they all fail to capture the time value of money.

3. Discounting Methods:

Following discounting techniques are generally used while evaluating the projects:

i. Net Present Value Method (NPV)

ii. Profitability Index (PI)

iii. Internal rate of Return Method (IRR)

4. Net Present Value Method:

Under this method, projects are accepted if the present value of cash inflows over the life of project is greater than the present value of cash outflows. The difference ie the NPV adds to the wealth of the company.

The formula to calculate NPV is

$NPV = ACI \times PVIFA_{r\%,\ n\ years} - II \times PVIF_{r\%,\ n\ years}$

Where:

ACI = annual cash inflow

$PVIFA_{r\%, n\ years}$ = Present value interest factor for annuity at r% rate of return for n years ie life of the project during which it yields cash inflow.

II = Initial Investment

$PVIF_{r\%, n\ year}$ = Present value interest factor at r% rate of return for the year in which initial investment is made.

(Note: in case of unequal cash inflows present value of cash inflows is calculated by multiplying the each year's cash inflow by the present value interest factor of that particular year.)

5. Profitability Index (PI):

It shows the relationship between present value of net cash inflows and present value of cash outflows. It is the relative measure and is calculated as follows:
PI = Present value of cash inflows / Present value of cash outflows
The project may be accepted if PI is greater than 1.

6. Internal Rate of Return (IRR):

IIR is the discount rate at which the NPV of a project is Zero. In other words it is that discount rate at which the present value of cash inflows during the life of the project euals the present value of cash outflows of the project. It may be calculated as:

IRR = LDR + (HDR –LDR) x {(PV I – Cost) / (PV I – PV II)}

Where,
LDR= Lower discount rate
HDR = Higher discount rate
PV I= Present value of cash inflows at LDR
PV II = Present value of cash outflows at HDR
Cost = Total initial investment in the project or total cost of the project.
The project shall be acceptable if the IRR is greater than the required rate of return.

7. Parent Unit's Projctions and the Cash Flow:

In case of multinational capital budgeting decisions, the foremost question which arises is that whether the cash flows should be computed from the viewpoint of the parent company or from the view point of the subsidiary. This is so because the cash flow accruing to the subsidiary may not be represented entirely by the cash flow accruing to the parent company.

There may be several reasons and cases where there may be disparity between the cash flow of the subsidiary and the parent company, like:

- Tax rates in the home country and the host country may be different.
- Exchange rates prevailing between the currencies of home country and host currency.
- Cost of investment proposal may not justify the size of either the parent or subsidiary company.
- Impact cash flow of the parent company due to appreciation or depreciation in the currency of the host country etc.

The ethics of the corporate financial management are very clear on this issue; that the value of the project is determined by the net present value of the future cash flows available to the investors. Since, the parent is the investor, it is the cash flow of the parent company that is taken into account in the context of international capital budgeting. Therefore, cash flow accruing to the parent company from the subsidiary company in the form of royalty or technical know-how fees is considered as cash inflow. Any cash flowing from the parent company to the subsidiary company is treated as cash outflow.

The parent company will agree to invest in a foreign project only if the net present value of the cash flow is positive from its own view point. The parent company analysis cash flow under three major headings:

- Initial Investment
- Operating cash flow
- Terminal cash flow.

8. Parent – Subsidiary Perspective: An Alternative Approach:

It is often argued that for a more transparent appraisal of an investment project, project appraisal should be made both from the perspective of the parent as well as the subsidiary. In a survey of 121 US MNCs operating in early 1980s 48% of the decisions were made on the basis of projects cash flow, 36% decisions were made on the basis of parent company's cash flow and 16% of the decisions considered both the parent and subsidiary viewpoints (Stanley and Block, 1983)

Under this approach two NPV's are computed:

1. NPV from parent company's perspective (NPV_p)
2. NPV from subsidiary company's perspective (NPV_s)

The acceptance or rejection decision of the project is based upon the NPV of both, the parent and the subsidiary.

The possible results of the above calculation and the decision taken may be discussed as follows:

1. Both NPV_p and NPV_s are negative. In such case project should not be accepted.
2. Both NPV_p and NPV_s are positive. In such case project should be accepted.
3. $NPV_p > 0 > NPV_s$, Project may be accepted but there would be chances of loss in the value in terms of the host country's currency.
4. $NPV_p < 0 < NPV_s$, Project is attractive from the perspective of the subsidiary but not from the perspective of the parent company. The project may be accepted but it is doubtful how far it will be beneficial for the parent company.

9.8 Global Capital Structure

The objective of financial policy is to maximize the value of firm by choosing the suitable combination of the financing instruments. Financial policy includes decisions regarding the mix of debt and equity, the currency of denomination of debt and equity, maturity structure of debt, markets from where the capital is to be raised, the method of financing domestic and foreign operations and financial risk management. Through its access to international financial markets, multinational companies are in a position to minimize their cost of capital by raising funds from abroad.

(i) Cost of capital for a multinational firm:

As the multinational corporation (MNC) has become a norm rather than exception, need to internationalize the tools of domestic financial analysis is ostensible. The question which arises is: What cost of capital figure should be used in appraising the profitability of foreign investments? The multinational is assumed to finance its foreign subsidiaries in such a way that it is able to minimize its incremental weighted average cost of capital.

Suppliers of capital to the MNC associate the risk of default with the MNC's consolidated debt ratio. This is because bankruptcy or financial distress in any of the foreign subsidiaries could seriously impair the parent company's ability to operate domestically. Any deviations from the parent company's target capital structure will cause adjustments in the mix of debt and equity used to finance future investments.

(ii) Influence of corporate characteristics on its capital structure decisions:

Some of the firm specific characteristics affect its capital structure decisions such as:

1. **Stability of MNC's Cash Flow:** MNC's with more stable cash flows can handle more debt as it enjoys a constant stream of cash inflows adequate enough to cover periodic interest payments. Conversely, MNC's with inconsistent cash flows prefer to keep low debts in its capital structure. MNC's which are diversified across many countries generally experiences constant cash flows, hence are in the position to handle debt intensive capital structure.

2. **MNC's Credit Risk:** MNC's which have less credit risk have easy access to credit. For example, if an MNC's management is considered to be strong and efficient, MNC's credit risk would be low, thus allowing for easier access to debt. MNC's that have assets which are easily acceptable as collateral are able to obtain loan easily as compared to the MNC's not having the assets acceptable as collateral.

3. **MNC's Access to Retained Earnings**: MNC's that have high profitability and more retained earnings are in a position to finance investments through retained earnings thus relying upon the equity intensive capital structure. Growth oriented MNC's need to finance majorly from the debt and thus have more propotion of debt in their capital structure.

4. **MNC's Guarantees on Debt:** If the parent company backs the debt of its subsidiary, the subsidiary's borrowing capacity might increase. Thus the subsidiary might need less equity financing. However at the same time, parent's borrowing capacity reduces, as creditors not be willing to provide funds to the parent as the funds might be used to rescue the subsidiary.

5. **MNC's Agency Problems:** If an overseas subsidiary cannot be monitored y the investors of the parent company, than the agency cost increases. In such a case parent company may ask the overseas subsidiary to issue equity in the local market so that the managers there are monitored.

6. **MNC's exposure to country risk:** Parent company may sometimes be exposed to risk political and environmental constraints imposed by host country. In such cases, parent company asks overseas subsidiary to issue equity in the local market. Having local investors as the minority shareholders in the subsidiary may hold the host government from taking some adverse action.

9.9 Summary

International finance is the sub area of economics that encompasses the foreign investment, global financial system, vibrancy of exchange rates, and their impact on international trade operations and relations.Trade is an important constituent of international financial/ economic relations and assumes eminent position in the study of international finance. International financial system relates to the management of and trading in international money and monetary assets. The trade transactions give rise to: Borrowing and lending operations in foreign currencies / Trading in financial assets denominated in foreign currencies Foreign exchange transaction involving an exchange of one currency for another. The former type of transactions is the part of foreign currency market and the later forms the part of foreign exchange market. The two main functions of the foreign exchange market are to determine the price of the different currencies in terms of one another and to transfer currency risk from more risk-averse participants to those more willing to bear it. The exchange rate of the domestic currency is expressed as equivalent to a certain number of units of a foreign currency. This is known as direct quote. Indirect quotation is also known as the quantity quotation. The exchange rate of a foreign currency is expressed as equivalent to a certain number of units of the domestic currency.The term Capital Account Convertibility (CAC), means relaxing controls on capital account transactions. The control may be imposed in any of the following ways: Quantitative restriction on capital movement. Multiple exchange rate system. Foreign Direct Investment (FDI) refers to investment in a foreign country where the investor retains control over the investment. 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. A global depository receipt or global depositary receipt (GDR) is a certificate issued by a depository bank, which purchases shares of foreign companies and deposits it on the account. GDRs represent ownership of an underlying number of shares.The decision to invest abroad takes a concrete shape when a future project is evaluated in terms of value addition to the investing company. The evaluation of long term capital investment projects is known as capital budgeting. The objective of financial policy is to maximize the value of firm by choosing the suitable combination of the financing instruments.Through its access to international financial markets, multinational companies are in a position to minimize their cost of capital by raising funds from abroad.

9.10 Key Words

- **Foreign Exchange Rate:** Is the value at which country's currency unit is exchanged for another country's currency unit.
- **Capital Account Convertibility:** Means relaxing controls on capital account transctions.
- **GDRs:** Global Depositary Receipt is a certificate issued by a depository Bank which purchases shares of foreign companies and deposits it in the account GDR reprints ownership of an underlying number of shores.

9.11 Self Assessment Test

1. Describe international finance management?
2. What is foreign exchange market? Who can participate in a foreign exchange market?
3. Discuss the components of International Financial environment.
4. Define foreign exchange rate.
5. What is Direct and Indirect quote?

6. Explain the concept of capital account convertibility. Also discuss the implications of Full convertibility of Indian rupee.
7. Discuss the trend of foreign institutional investment in India since liberalization.
8. What do you understand by the term international equity? Discuss the concept of ADR/GDR.
9. Discuss the capital budgeting techniques with reference to multinational firms.
10. What factors determine the capital structure of a multinational firm?

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Unit- 10 : International Financial Institutions and Liquidity

Unit Structure:

10.0 Objectives

After reading this chapter you will be able to :

- Understand the Organisational set-up , resource base and roles of IMF and World Bank Group
- Discuss the functions and financing activities of IFC.
- Evaluate the role and performance of IMF and IBRD (World Bank) in maintaining international liquidity.
- Compare the features of facilities available with each of the International Institution viz. IMF, World Bank, IFC, IDA, MIGA,UNCTAD

10.2 Introduction

There are many international financial institutions funding and assisting the development of nations important business. Some of them are very famous and every individual in aware of these institutions and their role. Some of them like IMF, World Bank, Asian Development Bank are famous organisation. IMf has several schemes financial assistance for countries with balance of payment (BOP) problems. In this unit we will discuss IMF and its financial instruments like SDRs, World Bank, International Finance Corporation and International Development Association. At the and we will give summary, key words, self assessment test and References.

10.2 International Monetary Fund

The International Monetary Fund (IMF) is an organization of 187 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.

With its near-global membership of 187 countries, the IMF is uniquely placed to help member governments take advantage of the opportunities—and manage the challenges—posed by globalization and economic development more generally. The IMF tracks global economic trends and performance, alerts its member countries when it sees problems on the horizon, provides a forum for policy dialogue, and passes on know-how to governments on how to tackle economic difficulties. The IMF provides policy advice and financing to members in economic difficulties and also works with developing nations to help them achieve macroeconomic stability and reduce poverty.

Marked by massive movements of capital and abrupt shifts in comparative advantage, globalization affects countries' policy choices in many areas, including labour, trade, and tax policies. Helping a country benefit from globalization while avoiding potential downsides is an important task for the IMF. The global economic crisis has highlighted just how interconnected countries have become in today's world economy.

The IMF supports its membership by providing:

- Policy advice to governments and central banks based on analysis of economic trends and cross-country experiences;
- Research, statistics, forecasts, and analysis based on tracking of global, regional, and individual economies and markets;
- Loans to help countries overcome economic difficulties;
- Concessional loans to help fight poverty in developing countries; and
- Technical assistance and training to help countries improve the management of their economies.

- **Objectives of IMF**

The IMF was founded more than 60 years ago toward the end of World War II.The founders aimed to build a framework for economic cooperation that would avoid a repetition of the disastrous economic policies that had contributed to the Great Depression of the 1930s and the global conflict that followed.

Since then the world has changed dramatically, bringing extensive prosperity and lifting millions out of poverty, especially in Asia. In many ways the IMF's main purpose—to provide the global public good of financial stability—is the same today as it was when the organization was established. More specifically, the IMF continues to

- provide a forum for cooperation on international monetary problems
- facilitate the growth of international trade, thus promoting job creation, economic growth, and poverty reduction;
- promote exchange rate stability and an open system of international payments; and
- lend countries foreign exchange when needed, on a temporary basis and under adequate safeguards, to help them address balance of payments problems

- **Organization of IMF**

The IMF has a management team and 17 departments that carry out its country, policy, analytical, and technical work. One department is charged with managing the IMF's resources. The IMF is led by a Managing Director, who is head of the staff and Chairman of the Executive Board. The Managing Director is assisted by a First Deputy Managing Director and three other Deputy Managing Directors. The Management team oversees the work of the staff, and maintain high-level contacts with member governments, the media, non-governmental organizations, think tanks, and other institutions.

10.3 International Liquidity and SDRs

The Special Drawing Right (SDR) is an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries. The SDR is neither a currency, nor a claim on the IMF. Rather, it is a potential claim on the freely usable currencies of IMF members. Holders of SDRs can obtain these currencies in exchange for their SDRs in two ways: first, through the arrangement of voluntary exchanges between members; and second, by the IMF designating members with strong external positions to purchase SDRs from members with weak external positions. In addition to its role as a supplementary reserve asset, the SDR serves as the unit of account of the IMF and some other international organizations. In addition to its role as a supplementary reserve asset, the SDR serves as the unit of account of the IMF and some other international organizations.

1. SDR's value:

The value of the SDR is based on a basket of key international currencies—the euro, Japanese yen, pound sterling, and U.S. dollar. The U.S. dollar-value of the SDR is posted daily on the IMF's website. The basket composition is reviewed every five years by the Executive Board to ensure that it reflects the relative importance of currencies in the world's trading and financial systems.

The SDR interest rate provides the basis for calculating the interest charged to members on regular (nonconcessional) IMF loans, the interest paid and charged to members on their SDR holdings, and the interest paid to members on a portion of their quota subscriptions. The SDR interest rate is determined weekly and is based on a weighted average of representative interest rates on short-term debt in the money markets of the SDR basket currencies.

2. SDR allocations to IMF members:

Under its Articles of Agreement, the IMF may allocate SDRs to members in proportion to their IMF quotas, providing each member with a costless asset. However, if a member's SDR holdings rise above its allocation, it earns interest on the excess; conversely, if it holds fewer SDRs than allocated, it pays interest on the shortfall.

There are two kinds of allocations:

(a) General allocations of SDRs:

General allocations have to be based on a long-term global need to supplement existing reserve assets. Decisions to allocate SDRs have been made three times: in 1970-72, for SDR 9.3 billion; in 1979–81, for SDR 12.1 billion; and in August 2009, for an amount of SDR 161.2 billion.

(b) Special allocations of SDRs.:

A special one-time allocation of SDRs through the Fourth Amendment of the Articles of Agreement was implemented in September 2009. The purpose of this special allocation was to enable all members of the IMF to participate in the SDR system on an equitable basis and correct for the fact that countries that joined the Fund after 1981—more than one-fifth of the current IMF membership—had never received an SDR allocation.

With the general SDR allocation of August 2009 and the special allocation of Setember 2009, the amount of SDRs increased from SDR 21.4 billion to SDR 204.1 billion (currently equivalent to about $317 billion).

10.4 World Bank

The International Bank for Reconstruction and Development (IBRD)or the World Bank aims to reduce poverty in middle-income and creditworthy poorer countries by promoting sustainable development through loans, guarantees, risk management products, and analytical and advisory services. Established in 1944 as the original institution of the World Bank Group, IBRD is structured like a cooperative that is owned and operated for the benefit of its 187 member countries.

IBRD World Bank raises most of its funds on the world's financial markets and has become one of the most established borrowers since issuing its first bond in 1947. The income that IBRD has generated over the years has allowed it to fund development activities and to ensure its financial strength, which enables it to borrow at low cost and offer clients good borrowing terms.

At its Annual Meeting in September 2006, IBRD (the World Bank) — with the encouragement of its shareholder governments — committed to make further improvements to the services it provides its members. To meet the increasingly sophisticated demands of middle-income countries, IBRD is overhauling financial and risk management products, broadening the provision of free-standing knowledge services and making it easier for clients to deal with the Bank.

Founded in 1944 to help Europe recover from World War II, the International Bank for Reconstruction and Development (IBRD) is one of five institutions that make up the World Bank Group. IBRD is the part of the World Bank (IBRD/IDA) that works with middle-income and creditworthy poorer countries to promote sustainable, equitable and job-creating growth, reduce poverty and address issues of regional and global importance.

Structured something like a cooperative, IBRD is owned and operated for the benefit of its 187 member countries. Delivering flexible, timely and tailored financial products, knowledge and technical services, and strategic advice helps its members achieve results. Through the World Bank Treasury, IBRD clients also have access to capital on favorable terms in larger volumes, with longer maturities, and in a more sustainable manner than world financial markets typically provide. The World Bank Specially:

- Supports long-term human and social development needs that private creditors do not finance;
- Preserves borrowers' financial strength by providing support in crisis periods, which is when poor people are most adversely affected;
- Uses the leverage of financing to promote key policy and institutional reforms (such as safety net or anticorruption reforms);
- Creates a favorable investment climate in order to catalyze the provision of private capital;
- Provides financial support (in the form of grants made available from the IBRD's net income) in areas that are critical to the well-being of poor people in all countries.

IBRD (World Bank) aims to reduce poverty in middle-income and creditworthy poorer countries by promoting sustainable development through loans, guarantees, risk management products, and (non-lending) analytical and advisory services.

IBRD (World Bank) has three main business lines:

- Strategy and Coordination Services
- Financial Services
- Knowledge Services
  - Poverty Assessments
  - Social and Structural Reviews
  - Public Expenditure Reviews
  - Sector Reports
  - Country Economic Memoranda
  - Knowledge Sharing

10.4 .1 International Finance Corporation(IFC)

The IFC, an affiliate of the World Bank, was established in 1956.Since IFC is an institution of the World bank Group; the membership in the World Bank is a prerequisite for membership in the IFC, legally and financially, but the IFC is a separate entity. The corporation has its own operating and legal staff, but draws upon the World Bank for administration and other services.

The World Bank loans are available only to member country governments or with the guarantee of member country government. Further IBRD can only make a loan but it cannot participates in the equity of the project finance. But the IFC was established with the specific purpose of promoting private sector investment, both foreign and domestic, in developing member countries.

Organization: To be a member of IFC,a country must first be a member of IBRD. Currently IFC has 178 member countries which collectively determine its policies and approve investments. IFC organizational set up is similar to that of the World Bank. The Board of Governors of the IBRD also constitutes the Board of Governor of IFC; but it is a separate entity with funds kept separate from those IBRD. The powers of IFC are vested in the board of Governors which normally meets once in a year. It is an apex body. Board of directors implements the policies framed by the Board of Governors. The 24 executive directors of the World Bank constitute the Board of Directors of the IFC, responsible for the general operation. The president of the World Bank is the ex-officio president of the IFC, he is also the chairman of the Board of Directors of IFC. The president is assisted by the Executive Vice-President who is in turn assisted by a large number of professional and non-professional staff.

Mission and Objectives: IFC's mission is to promote sustainable Private Sector investment in developing countries, helping to mobilize domestic and foreign capital for reducing poverty and improve standard of living .The goal of IFC is to deliver impact of development . IFC's basic tools to achieve this goal remain loan and equity financing of private enterprises , mobilization of external capital alongside its own resources, and provision of related advisory and technical assistance services. Following are the other objectives-

- To stimulate the flow of private capital into productive private, mixed private and public enterprises.
- To coordinate capital and management.
- To act as catalyst in bringing together entrepreneurship, investment,capital and production.
- To persuade capitalist countries to invest in developing countries.

- **Functions of IFC and its Resources**

Functions: The purpose of the IFC is further to the economic development by encouraging growth of private enterprise in member countries, Particularly in the less developed countries, supplementing the activities of the IBRD. The IFC, therefore,

- Provides loan to private industries of developing nations without any government guarantee and also promotes the additional capital investment in these countries, where sufficient private capital is not available on reasonable terms.
- Ensure the financial support to private sector in developing countries.
- Seeks to bring together investment opportunities , private capital of both foreign and domestic origin ,and experienced management.
- Aggravate the conditions conducive to the flow of private capital, domestic and foreign, into productive investments in member-countries.

The resources of IFC consist of capital contributed by its members and accumulated reserves. The member countries also hold voting rights in proportion to their contribution. Its authorized capital is USD 2.45 billion. It can also borrow from the World Bank for the purpose of lending activities because of its strong shareholder support; an amount equal to four times its unimpaired subscribed capital and surplus.

Assistance: IFC promotes development in member countries by providing assistance to private investors in the form of-

- Financial Assistance
- Advisory Services
- Resource Mobilization

- **Financial Assistance**

The IFC makes its investments in partnership with private investors from the capital exporting country or from the country in which enterprise is located, or both.It focuses on economic growth of developing nations by promoting growth of productive enterprises by offering various financial instruments to private organizations of a developing country, these include Long term loans in major and local currencies ,at fixed or variable rates, equity investments, Quasi-equity instruments(e.g. subordinated loans, preferred Stock, Income notes, convertible debt),Syndicate loans, Risk Management such as intermediation of currency and interest rate swaps , provision of hedging facilities, intermediary finance etc. With these instruments , IFC helps organizations ,structure financial packages and coordinate finance from other foreign and local players.

It is envisaged that the corporation limits its contribution to about 25%, or in special cases to 35% of the total financial requirements of the enterprise .But the presence of IFC often plays a catalytic role and encourages other financial institutions to participate as well. Its investment range from $1 million to $100 million in a various projects ranging manufacturing to tourism to health programs. The enterprises eligible for loans from the corporation should be predominantly industrial and contribute to the economic development of the country.The rate of interest is a matter of negotiation depending upon the risk and other investments.The IFC will not seek any government guarantee and any formal government proposal for repayment of any investment and proposed financing ,except required by the law of any country.

1. Advisory services of IFC :One important feature that distinguishes the IFC from other commercial financial institutions is its commitment to provide project sponsors with a range of advisory services to governments and private sector, helping their ventures potentially productive , financially and strategically sound policies. These services are provided either with financial service or by policy assistance in support of their efforts to develop the necessary investment climate to encourage productive and beneficial domestic and foreign investment. To a Private enterprise ,IFC may provide guidance in Project Development Assistance, Business Advisory Assistance, Restructuring and necessary Technical Assistance, while for the government of developing country IFC advice on developing a conducive business environment, Foreign Direct investment(FDI) and Privatization .

2. Resource Mobilization by IFC: Recognising the important contributions of Financial markets to economic development, the IFC has a specialized department that is the focal point of the capital market development activities of the IFC and the World bank . The department provides specialized resources for addressing the financial market needs and problems of developing countries. In response to the economic situation ,IFC expanded its operation in physical and financial restructuring of existing firms(Corporate restructuring). In addition, it helped to create bonding facility for construction firms, operating outside their own country ,helped to establish secondary mortgage marketing institution, and provided financing for regionally oriented venture capital company. Since IFC limits its participation to about 25% of the resource requirement, it helps companies in developing countries to tap international markets effectively. Owning to its past record, it acts as a catalyst for institutions which would not invest without IFC's presence. IFC uses its vast network of contacts to reach the right sponsors or parties that may be interested in investing in a particular project. The cornerstone of IFC's mobilization efforts is the loan participation program which arranges syndicated loans from banks.

- **IFC and India**

The IFC has assisted a number of projects in India. The new economic policy of India which has substantially enhanced the role of the private sector implies a greater role for the IFC in the industrial development of the country .The corporation has identified five priority areas in India for reinforced activities include capital markets development, direct foreign investment ,access to foreign markets, equity investments in new and expanding companies to finance capital investments and infrastructure. India is the first of the IFC's member countries to benefit from such a decentralization. IFC will invest in a range of financial service companies and provide help for India's capital market. It could act a catalyst by bringing together Indian and foreign companies to channal the flow of foreign investment and technology in India. IFC will strengthen its effort to funding in the international financial market through loan syndication and underwriting of securities issue for Indian companies. It is giving special emphasis to equity investments in the internationally competitive Indian Companies.

- **Multilateral Investment Guarantee Agency (MIGA)**

The World Bank established the Multilateral Investment Guarantee Agency (MIGA) in 1988 as its affiliate to promote foreign investment in developing countries by issuing guarantees against non-commercial risks .The membership is open to all World Bank members. Current membership is 164.Since its inception , MIGA had provided 650 guarantees in 85 developing countries. MIGA is an insurer not a lender .It mobilizes investment through its Cooperative underwriting programme (CUP), so that private sector parties are encouraged to take up projects they otherwise would not. MIGA provides guarantee to private investors against the risk of transfer restriction (including inconvertibility), expropriation, war and civil disturbances and breach of contract.

1. Mission and Objectives: The MIGA's mandate is to promote foreign direct investment by offering political risk insurance (guarantees) to investors and lenders, and by providing skills and resources to help encouraging economies attract and retain this investment. It's mission is to promote flow of foreign direct investment into emerging economies to improve people's lives and to reduce poverty. It even acts as a mediator in case of investment disputes.

2. MIGA's Guiding Principles Include:

- Focusing on clients to help investors, lenders and host country governments by encouraging private enterprises and foreign investments.
- Working with other insurers like other government agencies and other insurers to provide better services and increased development.
- Striving to improve the lives of people in emerging economies-by ensuring sound business, social and financial environment.
- Balancing development goals and financial objectives-through prudent underwriting and sound risk management.

3. Functions:

- **Investment Facilitation:** MIGA promotes foreign investment in developing countries by bringing together the investors, the government and the project sponsors. It also ensures investment made by state owned enterprises if they operate on commercial basis. The guarantee coverage provided by MIGA is up to 15 years, and occasionally up to 20 years. The guarantee coverage requires investors to adhere to world's best social and environmental standards. By providing guarantees to investors against non-commercial risks, MIGA helps to promote foreign direct investment in developing countries. MIGA's capacity to serve as an objective intermediary and to influence the resolution of potential disputes enhances investor's confidence that they will be protected against these risks.
- **Capacity Building:** MIGA develops and enhances skills, knowledge and tools by training clients and helping them develop marketing and management techniques. It helps in finalizing their policies and structures so that they made be attractive to foreign investments.
- **Information Distribution:** MIGA provides information on investment on investment opportunities, business operating conditions of an area and even suggests potential partners .It Provides online information to investors such as Investment Promotion Network, Privatization Link, FDI exchange etc.
- **Technical and Legal Assistance:** MIGA provides technical assistance and advisory services to help countries attract and retain foreign investment and to disseminate information on investment opportunities to the international business community. In addition it gives its legal services to smooth possible impediments to investment. Through its Dispute Mediation programme, it helps governments and investors resolve their differences and ultimately improve the country's investment climate.

4. Reinsurance Assistance: MIGA works in partnership with other investment insurers through its co-insurance and reinsurance programmes to expand the income capacity of the political risk insurance industry.

10.5 International Development Association (IDA)

The International Development Association (IDA) is an affiliate of the IBRD. It was established in September 24,1960 to provide 'soft loans' to countries that are too poor to borrow at commercial rates for economically sound projects which create 'social capital' such as the constructions of roads and bridges, slum clearance and urban development .The projects taken up by the IDA are such that fall under the category of 'high development priority' due to their benefits on the development on the area concerned ,but the returns from the projects are not sufficient to pay the high rates of interest on borrowings .The IDA provides loans for such projects interest free and for longer periods ,technical assistance and policy advice . Therefore, IDA is often referred as the 'soft loan window' of the World bank.

1. Organizaion: All the members of the IBRD are eligible to become members of IDA. The Board of Governors and Executive Directors of IBRD are also ex-officio Board of Governors and Executive Directors of IDA. At present 164 countries are member of IDA. The members are grouped into two parts. Part one consist of the members of industrially developed countries whose subscription can be freely used or who are required to contribute 10% of their subscription in the form of other currencies and the rest in their own currencies. Contribution in national currency are not used by IDA without the consent of the concerned country. IDA and IBRD are run on same principles, managed by the same staff, headquarters and report to the same president but draw on different resources and different lending patterns.

2. Resources: The industrially developed countries mainly contribute the resources for IDA. It includes subscribed capital by member countries, general replenishment by developed countries ,net income transferred by IBRD etc. Every three years the donor countries meet and decide the amount of their contribution to replenish IDA funds and also discuss IDA' s lending policies and future programs. Each such three year period for the purpose of replenishment is known by a number. Additional income come from the transfers from the net earning of the IBRD.

3. Lending: The IDA extends assistance to high priority projects in the member countries and provides loans, which are interest free with a repayment period of 35 to 40 years, followed by a 10 year grace period. It also provides grants to the poorest countries which cannot take loans from IBRD and do not have access to other financial markets .The finance may be made available to the member countries or to the private enterprise .Advances to private enterprise is given without the government guarantee. It also co-operates with other international institutions and member countries in providing financial and technical assistance to the less developed countries for better basic services such as education, health care and clean water and sanitations to their population and also supports their reforms and investments aimed at productivity growth and employment creation .It helps the nations to work towards the Millenium Development Goals in order to receive assistance from IDA ,the per capita gross national income, should be less than $965.

4. Features of Lending- The financial assistance of the IDA ha some special features:

(a) Interest free credit, only small service charge of 0.75% per annum is payable on the amount withdrawn and outstanding to cover administrative expenses.

(b) Long repayment period extending over 50 years. There is an initial moratorium for 10 years and the amount borrowed is repayable in the next 40 years.

(c) IDA finances not only the foreign exchange component but also a part of the domestic cost.

(d) Repayment can be made in the local currency of the borrowing countries, thus the repayment amount of loan does not burden the balance of payments of the country.

Before approving any credit to a member nation, a special committee of the IDA considers three criteria:

- Poverty Criterion- IDA's assistance is limited to the poorest countries with high population and low productivity due to excessive dependence on volatile primary products markets, heavy debt burdens resulting in low standard of living.
- Project Criterion- IDA projects are appraised according to the same standard as that applied to the bank projects. This criteria requires that the proposed project, for which credits are to be utilized must yield financial and economic returns .
- Performance Criterion-The past success in project execution and satisfactory overall economic policies renders the performance of the country, in terms of loan received, is evaluated.

5. IDA and India: India is one of the founder members of the IBRD and is one of the largest beneficiaries of the IBRD-IDA assistance during 1995-96 until China became the member of the World Bank in 1980.Now there are a number of larger beneficiaries than India. Over the years, the roles of the World bank and the IDA almost reversed as regards the assistance to India. The decline in the share of soft loan naturally increases India's debt burden. India's share in the IDA's global credit has declined over the years. Apart from the resource crunch IDA has been facing ,China's entry into the world bank has seriously affected the fund flow to India. Although the World Bank assistance to India is very large in absolute terms, the per capita assistance has been low. India, with about a third of the world's poor, needs a substantial increase in the concessional finance to accelerate the programs of poverty alleviation and economic development.

10.6. United Nations Conference on Trade and Development (UNCTAD)

The United Nations Conference on Trade, and Development(UNCTAD) has been advocating the cause of development as the objective of all trade and aid, particularly in respect of developing countries. Various international trade agreements commodity agreements have been promoted by the UNCTAD, which aims at stabilization of earnings of developing countries and improving their terms of trade. United Nations Conference on Trade and Development was established in the year of 1964 with its members amounting to 164.UNCTAD has an expression of the belief that a cooperative effort of the international community was required to integrate developing countries successfully into the world.

1. Organization: The UNCTAD is a permanent organ of the UN General Assembly. The conference, which is UNCTAD's highest decision making body, meets every four years to set priorities and guidelines for the organization, and provides an opportunity to consideration of key economic and development issues. Twelve conferences have been so far held under the patronages of UNCTAD. Its headquarter is at Geneva (Switzerland).IMF got the permanent representation in all its bodies. UNCTAD recommendations are only suggestions and no country can be compelled to accept them. Its main body executive body is the Trade and Development board (TDB). It has four subsidiary organs to assist in its functions, namely

1) Committee on commodities
2) Committee on Manufacturers
3) Committee on Shipping
4) Committee on Invisibles and Financing Related to Trade

The TDB is composed of 55 members elected by the full body of the conference from its members on the basis of equitable geographical distribution. It meets twice in a year. Though UNCTAD is functioning as a permanent agency of the UNO, but its membership is fully optional for Any country may join or quit the membership of UNCTAD. The functioning is based on democratic principles. Every member has only one voting right. For general disputes, simple majority is required among present members but two-third majority is needed for important issues.

2. Mission and Objectives: UNCTAD aims at the development-friendly integration of developing countries into the world economy. The primary objectives which lead to the conceivement and establishment of this institute may be divided under the following heads-

- To promote international trade especially with a view to accelerating the economic development of underdeveloped countries.
- To provide a forum to developing countries for discussing problems relating to their economic developments as the existing institutions like GATT and IMF were unable to handle the problems of economic developments for developing countries properly.
- To formulate the policies and principles for developing countries in the fields of trade, aid, transport, technology, finance etc.
- To negotiate multinational trade agreements between nations for the fulfillment of the purpose of economic and overall development of the member developing and underdeveloped countries.
- To propose the strategy for implementing pre-approved principles and policies and provide a suitable platform for trade dialogues.
- To assist Economic and social Council of the UNO.

The major activities of the UNCTAD include research and support of negotiations for commodity agreements, technical elaboration of new trade schemes ,such as new import preference system ,and various promotional activities designed to assist developing countries in the areas of trade and capital flows.

3. Basic Principles:

UNCTAD's action programme and principles have been laid down the various recommendations adopted by the first conference in 1964.These recommendations are based on the following basic principles:

1) Every country has the sovereign right freely to dispose of its natural resources in the interest of the economic development and well being of its own people and freely to trade with other countries.

2) Economic relations between countries, including trade relations , shall be based on respect for the principles of sovereign equality of states, self determination of people, and non-interference in the internal affairs of other countries.

3) There shall be no discrimination on the basis of differences in socio-economic systems and the adoption of various trading policies shall be consistent with this principle.

4. Functions: The principle functions of UNCTAD are –

- To promote international trade and aid among all the countries with a view to propell the economic development.
- To frame policies for the international trade and related problems conducive to economic growth.
- To formulate proposals for putting into effect the above policies.
- To review and facilitate the coordination of activities of the other institutions within the UN.
- To be available as a centre for harmonious trade and related documents on development policies of governments.

Against the backdrop of surging food prices and global economic uncertainties, UNCTAD XII ended with adoption of comprehensive conclusions aimed at reinforcing international efforts to extend gains from globalization to the millions being left behind.

Created in 1964, UNCTAD is responsible for helping developing countries integrate into the world economy so that they benefit as much as possible from trade, investment and development. It aims to guide debate and reflection on global development questions so that the combination of national policies and international action generates sustainable development. It is the only organization in the UN system to treat development questions in an integrated manner.

Review of the functioning of the UNCTAD-

UNO declared 1960-70 as Development Decade. In July 1962,a conference of developing countries was held at Cairo which resolved to convene a World Conference for this purpose. Economic and Social Council of UNO organized a World Trade and Development Conference from March 31, 1964 to June 16, 1964.A world wide international trade policy was determined in this conference. Various issues related to extension of international trade of developing countries were also discussed in that conference. This was the first UNCTAD-I conference. After that UNCTAD has made significant contribution to the efforts of developing countries to participate and adapt the changes in the world economy. UNCTAD has provided an invaluable forum for advancing the interrelationship between trade and development, from both national and international perspective. Despite the debates and disagreements over the years ,UNCTAD played a key role in the emergence of:

1. The Generalised System of Preference(GSP)
2. A maritime shipping code
3. Special international Programs to help the least developed countries
4. International aid targets.

During the 1970's, in line with the major changes in the international economic environment-the breakdown of the Bretton Woods System , oil price shocks , inflation and accumulation of debt by many developing countries-UNCTAD became a central forum for debates between the North and the South. Its negotiations became politically charted and most of its sessions during the 1970's and 1980's reflected sharp divisions between participants, even as global consensus seemed to be emerging in the 1980's.

10.7 Summary

In this unit we have studied the organization recourses and role of famous world financial institutions. The twin financial institutions the IMF and the world Bank were established as a result of Bratton woods conference in 1944. The importance of there institutions have grown many folds over the years. These institutions have addressed the problem of international liquidity through its institutions.

10.8 Key Words

- **IMF:** International monetary fund was estatrlished on December 27, 1945 with 29 countries as a result of Bratton woods conference of nations held in 1944.
- **World Bank or IBRD:** World Bank or International Bank for Reconstruction and Development is an important organization at international level formed to provide financial assistance on concessional rates.
- **IBA:** International Development Association is a member of world bank group. It was established in 1960 to promote growth and remove poverty.
- **SDRs:** Special Drawing rights is an international reserve asset created by IMF in 1969. The value of SDR is based on a basket of key international currencies.

10.9 Self Assessment Test

1. State whether true(T) or False(F)
   (a) UNCTAD came to existence in 1964.
   (b) The voting rights in IMF are proportional to the quota handling.
   (c) IMF lending is conditional on economic policies to be pursed by the borrowing country.
   (d) IMF stands guarantee when a member country which has sold SDRs fail to repurchase.
   (e) The major resource of IBRD comes from borrowing in world financial markets.
   (f) IDA loans are available to private enterprises also.
   (g) The distinctive feature of IFC as compared to IBRD is that it can participate in the equity of the project financed.
   (h) IFC finances only profit oriented projects.
   ANS: (a) True (b) True (c) True (d) False (e) True
   (f) True (g) True (h) True
2. Fill in the Blanks-
   a) The subscription of member countries to IMF is known as __________.
   b) Membership of IBRD is confined to the members of__________.
   c) __________is known as the soft loan window of the world bank.

d) IFC finances exclusively _____________ sector enterprises.

e) MIGA was established in ___________.

Ans- a. Quota b. IMF c. IDA d. Private e.1988

3. Multiple choice questions-

I. Least developed countries get funds :

(a) Only from IDA

(b) Only from the IBRD

(c) Both from the IBRD and IDA

(d) None of the Above

II. The role of IMF does not include-

(a) monitoring the proper conduct of the international monetory system

(b) lending to socially oriented projects

(c) financing temporary balance of payments deficits of member countries

(d) providing source of liquidity to member countries

III. With reference to IMF, the term 'reserve tranche' refers to –

(a) borrowing from IMF that takes the IMF's holding of the currency of the country up to 100% of country's quota

(b) subscription reserved for calling during emergencies.

(c) the investments in which the reserves of IMF are held.

(d) borrowing reserved for very poor countries.

IV. SDR stands for-

(a) Special Drawing Rights

(b) Specific Drawing Rights

(c) Special Depository Rules.

(d) None of the above

V. The term world bank refers to –

(a) IBRD

(b) IDA

(c) Both IBRD and IDA

(d) IFC

VI. The eligibility to borrow from IDA is based on –

(a) relative poverty

(b) lack of credit worthiness to borrow on market terms

(c) good policy performance

(d) all of the bove

VII. Financial products of IFC does not include-

(a) loans

(b) equity participation

(c) risk management products

(d) none of the above

VIII. MIGA stands for-

(a) Multilateral Investment Guarantee Agency

(b) Multilateral Institutional and Government Agencies

(c) Mutual Interest Guaranteeing Agencies.

(d)none of the above

Ans : I. (c)	II. (b)	III. (a)	IV.(a)
V. (c)	VI. (d)	VII. (d)	VIII.(a)

Theory Questions:

Short Answer Questions-

1. State the Objectives of IMF
2. Name the main sub organizations of IBRD.
3. Are the lending terms of IBRD and IDA different ?
4. Write short note on MIGA.
5. What are the functions of UNCTAD ?

Long Answer questions-

1. Discuss the concept and signifiance of SDR's for developing nations like India.
2. Comment on the World bank's lending policy.
3. Describe the functions of IFC and comment on its performance.
4. Describe the objectives,organisation and functions of International Development Adssociation.
5. What are the main purpose of IMF ? To what extent,in your opinion, have these purposes been fulfilled today ?

Test Your self-

1.IMF was established in ____________________

2.IBRD was established in the year ____________________

3. IBRD has three main business lines namely ________________________________

Test Your self-

1.IFC came into existence in_________.

2.IFC provides ______ types of assistance, namely_________________________.

➢ Test Your self-

1.Write the full name of MIGA_______.

2.Briefly explain the MIGA mission.

3.In how many areas functions of MIGA are classified __________.

Test Your self:

1.IDA was set up in ______.

2. IDA is also called __________ of UN.

3.IDA considers the criteria before sanctioning the loan

(a)_____ (b)_______ (c) __________

Test Your self-

1. UNCTAD stands for_________.
2. Recent Conference of UNCTAD was held in __________

3. Discuss the basic principles of UNTAD in brief.

4. UNCTAD has four committees for its functioning, these are_______.

10.10 References

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Unit -11 : International Marketing

Unit Structure

11.0 Objective

After studying this unit you will be able:

- To provide an understanding of the factors which have led to the growth of internationalism and globalization.
- To produce a description of the major concepts and themes on which the subject of global marketing is based.
- To describe what is involved in planning for global marketing.
- Define international marketing and identify the different levels of international involvement.
- Describe the different company orientations and philosophies toward international marketing.
- Identify environmental and firm-specific drivers that direct firms toward international markets.
- Identify obstacles preventing firms from engaging in successful international ventures.

11.1 Introduction

International Marketing or global marketing refers to marketing carried out by companies overseas or across national borderlines. This strategy uses an extension of the techniques used in the home country of a firm. It refers to the firm-level marketing practices across the border including market identification and targeting, entry mode selection, marketing mix, and strategic decisions to compete in international markets.

International marketing is simply the application of marketing principles to more than one country. However, there is a crossover between what is commonly expressed as international marketing and global marketing, which is a similar term. For the purposes of this lesson on international marketing and those that follow it, international marketing and global marketing are interchangeable. According to *American Marketing Association (AMA)* "International marketing is the multinational process of planning and executing the conception, pricing, promotion and distribution of ideas, goods, and services to create exchanges that satisfy individual and organizational objectives." According to Doole and Lowe (2001) "At its simplest level, international marketing involves the firm in making one or more marketing mix decisions across national boundaries. At its most complex level, it involves the firm in establishing manufacturing facilities overseas and coordinating marketing strategies across the globe." Cateora and Ghauri (1999) "International Marketing is the performance of business activities that direct the flow of a company's goods and services to consumers or users in more than one nation for a profit. " Muhlbacher, Helmuth, and Dahringer (2006)"International marketing is the application of marketing orientation and marketing capabilities to international business. " Keegan (2002) The international market goes beyond the export marketer and becomes more involved in the marketing environment in the countries in which it is doing business. " Johansson (2000) "Global marketing refers to marketing activities coordinated and integrated across multiple country markets." In contrast to the definition of marketing only the word multinational has been added. In simple words international marketing is the application of marketing principles to across national boundaries. However, there is a crossover between what is commonly expressed as international marketing and global marketing, which is a similar term.

The intersection is the result of the process of Internationalisation. Many American and European authors see international marketing as a simple extension of exporting, whereby the marketing mix 4P's is simply adapted in some way to take into account differences in consumers and segments. It then follows that global marketing takes a more standardized approach to world markets and focuses upon sameness, in other words the similarities in consumers and segments.

11.3 Evolution of Global Marketing

Whether an organisation markets its goods and services domestically or internationally, the definition of marketing still applies. However, the scope of marketing is broadened when the organisation decides to sell across international boundaries, this being primarily due to the numerous other dimensions which the organisation has to account for. For example, the organisation's language of business may be "English", but it may have to do business in the "French language". This not only requires a translation facility, but the French cultural conditions have to be accounted for as well. Doing business "the French way" may be different from doing it "the English way". This is particularly true when doing business with the Japanese. Let us, firstly define "Marketing" and then see how, by doing marketing across multinational boundaries, differences, where existing, have to be accounted for. S. Carter defines marketing as: "The process of building lasting relationships through planning, executing and controlling the conception, pricing, promotion and distribution of ideas, goods and services to create mutual exchange that satisfy individual and organisational needs and objectives".

The long held tenants of marketing are "customer value", "competitive advantage" and "focus". This means that organisations have to study the market, develop products or services that satisfy customer needs and wants, develop the "correct" marketing mix and satisfy its own objectives as well as giving customer satisfaction on a continuing basis. However, it became clear in the 1980s that this definition of marketing was too narrow. Preoccupation with the tactical workings of the marketing mix led to neglect of long term product development, so "Strategic Marketing" was born. The focus was shifted from knowing everything about the customer, to knowing the customer in a context which includes the competition, government policy and regulations, and the broader economic, social and political macro forces that shape the evolution of markets. In global marketing terms this means forging alliances (relationships) or developing networks, working closely with home country government officials and industry competitors to gain access to a target market. Also the marketing objective has changed from one of satisfying organisational objectives to one of “stakeholder” benefits - including employees, society, government and so on. Profit is still essential but not an end in itself.

Marketing must still be regarded as both a philosophy and a set of functional activities. As a philosophy embracing customer value (or satisfaction), planning and organising activities to meet individual and organisational objectives, marketing must be internalised by all members of an organisation, because without satisfied customers the organisation will eventually die. As a set of operational activities, marketing embraces selling, advertising, transporting, market research and product development activities to name but a few. It is important to note that marketing is not just a philosophy or one or some of the operational activities. It is both. In planning for marketing, the organisation has to basically decide what it is going to sell, to which target market and with what marketing mix (product, place, promotion, price and people). Although these tenants of marketing planning must apply anywhere, when marketing across national boundaries, the difference between domestic and international marketing lies almost entirely in the differences in national environments within which the global programme is conducted and the differences in the organisation and programmes of a firm operating simultaneously in different national markets.

It is recognised that in the “postmodern” era of marketing, even the assumptions and long standing tenents of marketing like the concepts of “consumer needs”, “consumer sovereignty”, “target markets” and “product/ market processes” are being challenged. The emphasis is towards the emergence of the “customising consumer”, that is, the customer who takes elements of the market offerings and moulds a customised consumption experience out of these. Even further, post modernisim, posts that the consumer who is the consumed, the ultimate marketable image, is also becoming liberated from the sole role of a consumer and is becoming a producer. This reveals itself in the desire for the consumer to become part of the marketing process and to experience immersion into “thematic settings” rather than merely to encounter products. So in consuming food products for example, it becomes not just a case of satisfying hunger needs, but also can be rendered as an image - producing act. In the post modern market place the product does not project images, it fills images. This is true in some foodstuffs. The consumption of “designer water” or “slimming foods” is a statement of a self image, not just a product consuming act.

Acceptance of postmodern marketing affects discussions of products, pricing, advertising, distribution and planning. However, given the fact that this textbook is primarily written with developing economies in mind, where the environmental conditions, consumer sophistication and systems are not such that allow a quantum leap to postmodernism, it is intended to mention the concept in passing. Further discussion on the topic is available in the accompanying list of readings.

When organisations develop into global marketing organisations, they usually evolve into this from a relatively small export base. Some firms never get any further than the exporting stage. Marketing overseas can, therefore, be anywhere on a continuum of “foreign” to “global”. It is well to note at this stage that the words “international”, “multinational” or “global” are now rather outdated descriptions. In fact “global” has replaced the other terms to all intents and purposes. “Foreign” marketing means marketing in an environment different from the home base, it’s basic form being “exporting”. Over time, this may evolve into an operating market rather than a foreign market. One such example is the Preferential Trade Area (PTA) in Eastern and Southern Africa where involved countries can trade inter-regionally under certain common modalities. Another example is the Cold Storage Company of Zimbabwe.

11.3 Importance of International Marketing

Going international is not a new phenomenon. In the age of globalisation it has become very popular. The Universal economic liberalization has boosted the number of firms going global. Normally, international marketing refers to the international flow of goods and services. Today there is an international spread of culture of going global through many media from music to movies to books. The information technology revolution has joined the cultures of various countries and it has become easier to communicate through internet video and audio phones. In short, contacts between people and their cultures. Their ideas, their value, their ways of life has been growing day by day. All these development have made world a single integrated economic unit. Centuries ago world experienced the same wind towards international trade and ended into spread of imperialism. As a result many scholars see the new love for free trade and spread of global culture as a new way of economic imperialism. During 1870 to 1913, an averwhelming proportion to international trade was inter-sectoral trade where primary commodities were exchanged for manufacturing goods. The trade was, it a significant, based on absolute advantage derived from natural resources or climatic conditions. But now the pattern of international trade has changed and it is based on scale of economics and product differtation . Michael Porter in his renouned book Competitive Advantage of Nations pointed out the advantage of competition. International marketing makes a firm big in size and it becomes easier for the firm to become strong to compete with other small firms and achieve the advantage of economics of scale.

In short international expansion helps from to utilize foreign for the development of the nation. The international marketing is important for the following reasons.

1. **Growth in Productivity**: As a result of production on large scale a firm receives comparative advantage. Income and standard of living go up faster.
2. **Competition:** Increase in competition would make companies more cost and quality conscious and innovative. Competition enhance consumer choice and consumer surplus.
3. **Larger Market:** A firm going international search larger market. Demand of their product goes up and they can purchase the cheap raw material. This further raise the productivity and profit.
4. **More Employment**: There are also a venues for more employment from firms going international.

11.4 Factors Affecting International Marketing

In the last 50 years the global economy has expanded in leaps and bounds. Companies from different parts of the world during most of those decades in different industries achieved great success by pursuing international, multinational, or global strategies. During the 1990s, changes in the business environment have presented a number of challenges to established ways of doing business. The forces affecting global integration are shown in Figure 9.1Growing importance of global marketing today stems from the fact that driving forces have more momentum than the restraining forces.

1 **Competition:** Converging market needs and wants, technology advances, pressure to cut costs, pressure to improve quality, improvements in communication and transportation technology, global economic growth, and opportunities for leverage all represent important driving forces; any industry subject to these forces is a candidate for globalization.

2 **Regional Economic and Political Integration:** The pace of global integration has been accelerated by number of multilateral trade agreements. NAFTA is already expanding trade among the United States, Canada, and Mexico. The General Agreement on Tariffs and Trade (GATT), which was

ratified by more than 120 nations in 1994, has been replaced by the World Trade Organization to promote and protect free trade, but it has come under attack by developing countries. In Europe, the expanding membership of the European Union is lowering barriers to trade within the region.

3 **Technology:** Once a technology is developed, it soon becomes available everywhere in the world. Technology is a universal factor that crosses national and cultural boundaries. Once a technology is developed, it soon becomes available everywhere in the world.

4 **Improvements in Transportation and Telecommunication:** Over the past 100 years the time and cost barriers associated with distance have fallen tremendously. The jet airplane revolutionized communication by making it possible for people to travel around the world in less than 48 hours. Tourism enables people from many countries to see and experience the newest products being sold abroad. One essential characteristic of the effective global business is face-to-face communication among employees and between the company and its customers. Without modern jet travel, such communication would be difficult to sustain. In the 1990s, new communication technologies such as e-mail, fax, and teleconferencing and videoconferencing allowed managers, executives, and customers to link up electronically from virtually any part of the world for a fraction of the cost of air travel.

5 **Costs of Product Development:** When new products require major investments and long periods of development time the pressure for globalization is intense. The Pharmaceuticals industry provides a striking illustration of this driving force. According to the Pharmaceutical Manufacturers Association (PMA), the cost of developing a new drug in 1976 was Rs 2408.4 million; by 1982, the cost had increased to Rs 3880.2 million. By 1993, the cost of developing a new drug had reached Rs 16011.4million. Such costs must be recovered in the global marketplace, as no single national market is likely to be large enough to support investments of this size. As noted earlier, global marketing does not necessarily mean operating everywhere; in the Rs 8920 billion pharmaceutical industry, for example, seven countries account for 75 percent of sales.

6 **Quality of Products:** A global and a domestic company may each spend 5 percent of sales on research and development, but the global company may have many times the total revenue of the domestic because it serves the world market. Global marketing strategies can generate greater revenue and greater operating margins, which, in turn, support design and manufacturing quality. Global companies "raise the bar" for all competitors in an industry. When a global company establishes a benchmark in quality, competitors must quickly make their own improvements and come up to par. Global competition has forced all companies to improve quality. For truly global products, uniformity can drive down research, engineering, design, and production costs across business functions. Quality, uniformity, and cost reduction were all driving forces behind Ford's development of its "World Car," which is sold in the United States as the Ford Contour.

7 **Trends in world Economy:** In the expansion of the international economy and the growth of global marketing there are three reasons why economic growth has been driving force. First, growth has created market opportunities that provide a major incentive for companies to expand globally. At the same time, slow growth in a company's domestic market can signal the need to look abroad for opportunities in nations or regions with high rates of growth.

8 **Needs and Wants of Market:** The common elements in human nature provide an underlying basis for the opportunity to create and serve global markets. The word create is deliberate. Most global markets do not exist in nature: They must be created by marketing effort. For example, no one needs soft drinks, and yet today in some countries per capita soft-drink consumption exceeds

the consumption of water. Marketing has driven this change in behavior, and today the soft-drink industry is a truly global one. Evidence is mounting that consumer needs and wants around the world are converging today as never before. This creates an opportunity for global marketing. Multinational companies pursuing strategies of product adaptation run the risk of being overtaken by global competitors that have recognized opportunities to serve global customers.

11.5 International Marketing Research

Market research is the collection and analysis of information about consumers, competitors and the effectiveness of marketing programs. Small business owners use market research to determine the feasibility of a new business, test interest in new products or services, improve aspects of their businesses, such as customer service or distribution channels, and develop competitive strategies. In other words, market research allows businesses to make decisions that make them more responsive to customers' needs and increase profits.

The Marketing Research Process

The research process provides a systematic, planned approach to the research project and ensures that all aspects of the research project are consistent with each other. The market research project conceived, planned, and executed through a research process, consisting of stages or steps that guide the project from its conception through the final analysis, recommendation, and ultimate action. The research process provides a systematic, planned approach to the research project and ensures that all aspects of the research project are consistent with each other. It is especially important that the research design and implementation be consistent with the research purpose and objectives

.Research studies evolve through a series of steps, each representing the answer to a key question.

1. *Why should we do research*? This establishes the research purpose as seen by the management team that will be using the results. This step requires understanding the decisions to be made and the problems or opportunities to be diagnosed.

2. *What research should be done*? Here the management purpose is translated into objectives that tell the researchers exactly what questions need to be answered by the research study or project.

3. *Is it worth doing the research*? The decision has to be made here about whether the value of the information that will likely be obtained is going to be greater than the cost of collecting it.

4. *How should the research be designed to achieve the research objectives*? Design issues include the choice of research approach—reliance on secondary data versus conducting a survey or experiment—and the specifics of how to collect the data.

5. *What will we do with the research*? Once the data have been collected, how will it be analyzed, interpreted, and used to make recommendations for

The basic functions of marketing research and the various stages in the research process do not differ between domestic and international research. The international marketing research (IMR) process, however, is much more complicated than the domestic research process. IMR is more complicated because of the necessity to ensure construct, measurement, sampling and analysis equivalence before any cross-cultural study is conducted. A thorough research of the proposed international market is very important before launching a new product or service. Although it is complex, it can be an extremely beneficial process.

To avoid high-profile mistakes in international marketing research, there are some considerations to be made:

1. Profile your target customers and clients.
2. Interview target segments to assess how well they match your preconceived ideas.
3. Hire local researchers who know the costs and methods that are workable in local markets
4. Use a variety of methods to get a well-rounded picture of these proposed markets, the best approach being a combination of qualitative and quantitative methods that provides picture references, strengths, beliefs, and anecdotes.
5. Look at the findings and analyze what must be done differently, abroad or internationally, in comparison with current domestic marketing activities.

11.7 Mode of Entering in International Markets

After the decision to invest has been made, the exact mode of operation has to be determined. The risks concerning operating in foreign markets is often dependent on the level of control a firm has, coupled with the level of capital expenditure outlayed. The principal modes of engagement are listed below:

- Exporting (which is further divided into direct and indirect exporting)
- Joint ventures
- Direct investment (split into assembly and manufacturing)

1. Exporting

Direct exporting involves a firm shipping goods directly to a foreign market. A firm employing indirect exporting would utilize a channel/intermediary, who in turn would disseminate the product in the foreign market. From a company's standpoint, exporting consists of the least risk. This is so since no capital expenditure, or outlay of company finances on new non-current assets, has necessarily taken place. Thus, the likelihood of sunk costs, or general barriers to exit, is slim. Conversely, a company may possess less control when exporting into a foreign market, due to not control the supply of the good within the foreign market.

2. Joint Ventures

A joint venture is a combined effort between two or more business entities, with the aim of mutual benefit from a given economic activity. Some countries often mandate that all foreign investment within it should be via joint ventures . By comparison with exporting, more control is exerted however the level of risk is also increased.

3. Direct Investment

In this mode of engagement, a company would directly construct a fixed/non-current asset within a foreign country, with the aim of manufacturing a product within the overseas market.

Assembly denotes the literal assembly of completed parts, to build a completed product. An example of this is the Dell Corporation. Dell possesses plants in countries external to the United States of America, however it assembles personal computers and does not manufacture them from scratch. In other words, it attains parts from other firms, and assembles a personal computer's constituent parts (such as a motherboard, monitor, CPU, RAM, wireless card, modem, sound card, etc.) within its factories. Manufacturing concerns the actual forging of a product from scratch. Car manufacturers often construct all parts within their plants. Direct investment has the most control and the most risk attached. As with any capital expenditure, the return on investment has to be ascertained, in addition to appreciating any related sunk costs with the capital expenditure.

11.8 International Product Strategy

International Product Strategy Consists of

- Extension: Sell the product as it is.
- Adaptation: Modify the existing for different countries or regions.
- Creation: Design new products for foreign markets.
- Globalization: Introduce one product globally.
- Identifying universal and market-specific product features
- Developing a Global Product
- Developing a basic product platform
- Building adaptability into the product to achieve worldwide appeal
- Introducing the product into countries in three or more regions in a short timeframe

In international marketing product and communication strategies are usually considered together because they are inseparable. Keegan identified the following five alternative product. Communication strategies:

1. **Straight Extension:** The theme of the straight extension strategy in one product one massage worldwide. In other words, under this strategy the firm markets the uniform product and gives the same message in all the markets. The strategy has been successfully employed by may international giants. It is less costly.
2. **Product Extension Adaptation Strategy:** Under this strategy the firm markets the same product but employs different communication in the markets. For example bicycles are used mainly for sporting and exercising in rich countries but in poor countries it is used for transportation. The product is modified for different countries as per their requirement.
3. **Product Adaptation:** Extension Strategy: Under this strategy essentially the product is designed and created as per the requirement of the country. The strategy assures that the product will serve the same function in different markets and under different use conditions.
4. **Dual Adaptation:** in dual adaptation the strategy adopts both the product and communication to meet the foreign market needs. The strategy is useful to address the environment conditions.
5. **Product Invention:** This strategy involves the development or creation of a new product as per the conditions and requirement of the foreign market. For example for poorer countries low cost products may be suitable.

   In sum, as Keegan points out, the choice of a product and communication strategy in international marketing is a function of three key factors such as:

   (i) The product it self defaced in terms of the functions or need it sesres;

   (ii) The market defined in terms of conditions under which the product is used;

   (iii) The costs of adaptation and manufacturing to the company.

The executive may choose the most profitable strategy based on product market and company's capabilities.

The Product/Market Life Cycle

The traditional four stage life cycle - introduction, growth, maturity, decline - is a well documented phenomenon. Attempts are made in the maturity stage to extend the cycle. The market life cycle is very similar and what global marketers have to be wary of is that not all markets are at the same stage globally. It may be appropriate to have tractor mounted ditchers and diggers in Africa or the UK where labour is not too plentiful, but in India, they may be the last thing required where labour is plentiful and very cheap. So the appropriate marketing strategy will be different for each market.

It would be very easy to discuss the global marketing decision as a case of deciding whether to export or standardise or adapt your product/market offering. This is far from the case. Even the smallest nuance of change in the global environment can ruin a campaign or plan. Whilst the above discussion has tended to be theoretical in nature, most of it, if not all of it, is essential in practice. In food marketing systems many transactions and discussions take place across international boundaries. This involves a close look at all the necessary environmental factors. If one considers food marketing as the physical and economic bridge linking raw materials production and consumer purchases then a whole series of interdependent decisions, institutions, resource flows and physical and business activities take place. Food marketing stimulates and supports raw material production, balances commodity supply and demand and stimulates end demand and enhances consumer welfare. This process often transcends several different industries and markets, many of them crossing international boundaries. The product may change form, be graded, packed, transported and necessitate information flows, financial resources, invoice and retailing or wholesaling functions. In addition, quality standards designed for producers and transporters may apply as may product improvements. In other words, the bridge may involve a whole set of utilities afforded to the end user (time, place and form), and add value at each stage of the transaction. This system involves numerous independent and interdependent players and activities. To shift a perishable like strawberries 7000km from Harare, Zimbabwe to the UK requires an extraordinary complex series of activities, involving perfect timing.

With commodities, physical, Government and economic environmental factors playing a major role in international marketing. So does price and quality differentiation. In later years the enormous success of the Brazilian frozen concentrated orange juice industry has been attributable not only to poor climatic conditions prevailing in its competitive countries, but the fact that its investment in large production economies of scale, bulk transport and storage technologies considerably reduced international transport costs and facilitated improved distribution of the juice to, and within, importing countries. From a cottage industry in 1970, it grew to account for 80% of world trade by the early 1990's. Its success, therefore, has been based on price and added value quality differentiation.

International marketing is, therefore, quite a complex operation, involving both an understanding of the theoretical and practical aspects involved. Prescriptions are totally inappropriate. This concludes the discussion on the reasoning why internationalism has grown and the next chapters' took more closely at the environmental factors which have to be taken into account when considering to market internationally.

11.9 International Pricing

The "right" price is what the customer will pay, not what you want to charge. Following factors should be considered before setting price for a product.

- Wherever possible, quote in the customer's own currency.
- Protect yourself against foreign exchange risk.

- Price is only relatively important, greater emphasis should be placed on non-price factors.
- The price-quality relationship is important.

Pricing Objectives

The firm's pricing objectives must be identified in order to determine the optimal pricing. Common objectives include the following:

- **Current profit maximisation** - seeks to maximize current profit, taking into account revenue and costs. Current profit maximization may not be the best objective if it results in lower long-term profits.
- **Current revenue maximisation** - seeks to maximize current revenue with no regard to profit margins. The underlying objective often is to maximize long-term profits by increasing market share and lowering costs.
- **Maximise quantity** - seeks to maximize the number of units sold or the number of customers served in order to decrease long-term costs as predicted by the experience curve.
- **Maximise profit margin** - attempts to maximize the unit profit margin, recognizing that quantities will be low.
- **Quality leadership** - use price to signal high quality in an attempt to position the product as the quality leader.
- **Partial cost recovery** - an organization that has other revenue sources may seek only partial cost recovery.
- **Survival** - in situations such as market decline and overcapacity, the goal may be to select a price that will cover costs and permit the firm to remain in the market. In this case, survival may take a priority over profits, so this objective is considered temporary.
- **Status quo** - the firm may seek price stabilization in order to avoid price wars and maintain a moderate but stable level of profit.

There are many ways to price a product some of them are:-

1 **Premium Pricing:** Use a high price where there is a uniqueness about the product or service. This approach is used where a substantial competitive advantage exists. Such high prices are charge for luxuries such as Lexus.

2 **Penetration Pricing** : The price charged for products and services is set artificially low in order to gain market share. Once this is achieved, the price is increased. This approach was used by France Telecom in order to attract new corporate clients.

3 **Economy Pricing:** This is a no frills low price. The cost of marketing and manufacture are kept at a minimum. Supermarkets often have economy brands.

4 Cost-plus pricing : The price is set at the production cost plus a certain profit margin.

5 Target return pricing : The price is set to achieve a target return-on-investment.

6 Value-based pricing : The Price is based on the effective value to the customer related to alternative products.

7 Psychological pricing : The price is based on factors such as signals of product quality, popular price points, and what the consumer perceives to be fair.

11.10 Distribution Channels

Distribution has two elements, the institutional and the physical. Physical distribution aspects cover transport and warehousing. The longer the channel, the more likely that producer's profits will be indirectly reduced. This is because the end product's price may be too expensive to sell in volume, sufficient for the producer to cover costs. Yet cutting channel length may be impossible, as country infrastructure requirements may dictate them being there. As already mentioned international marketers have the options of organizing distribution of their goods in foreign markets through the use of indirect channels, i.e. using intermediaries, direct channels or a combination of the two in the same or different markets.

Types of distribution channels are:-

1. Indirect Distribution

Indirect channels are further classified based on whether the international marketer makes use of domestic or foreign intermediaries. An international marketer therefore, can make use of the following types of intermediaries for distribution in foreign markets.

a) Domestic Overseas Intermediaries

- Commission buying agents
- Country-controlled buying agents
- Export management companies (EMCs)
- Export merchants
- Export agents
- Piggy backing

b) Foreign Intermediaries

- Foreign Sales Representatives
- Foreign Sales Agents
- Foreign Stocking and Non-Stocking Agents
- State Controlled Trading Companies

According to Cateora, the international distribution policy of a firm should cover the following factors:

1 Question of control, size of margins, length of channels, terms of sale and channel ownership.

2 Resource (money and personnel) commitment plans for the distribution function management keeping profit goals in a foremost position.

3 Specific market goals expressed in terms of volume, market share and margin requirements, to be accomplished.

4 Return on investment, sales volume and long run potential as well as guidelines for solving routine distribution problems.

5 The relationship between long-and short-term goals, the extent of the company's involvement in the distribution system as well as the extent of its ownership of middlemen.

11.14 Summary

The development of global marketing has been brought about by a number of variables both exogenous and endogenous. The evolution of global marketing has been in a series of four stages from exporting to truly global operations. These stages have been termed "domestic" in focus to "ethnocentric", "polycentric" and "geocentric". When planning to do global marketing, a number of "environmental" factors have to be considered but generally one is looking for "unifying" or "differentiating" influences which will dictate a "standard or "adapted" planning approach.

A number of concepts and techniques, including the International Product Life Cycle, can give insight and a guide to global planning.The "right" price is what the customer will pay, not what you want to charge. pricing can be done through premium, economy, penetration, cost plus value based, target return and psychological pricing methods. The longer the channel, the more likely that producer's profits will be indirectly reduced. This is because the end product's price may be too expensive to sell in volume, sufficient for the producer to cover costs. Yet cutting channel length may be impossible, as country infrastructure requirements may dictate them being there. so international marketers have the options of organizing distribution of their goods in foreign markets through the use of indirect channels, i.e. using intermediaries, direct channels or a combination of the two in the same or different markets.

11.15 Key Words

- **International Trade:** Trade across the foundries of a nation.
- **Global Environment:** The economics scenaris across the globe is referred as global environment .
- **International Marketing:** Marketing of goods and services in different countries.
- **Absolute advantage**: The absolute cost difference in the production of a product due to natural or other follow.
- **Comparative Advantage:** The relative cost differentiations in the cost of products of trading countries.

11.16 Self Assesment Test

1. What are the principal differences between marketing domestically and internationally or globally?
2. What factors have led to the growth of "Internationalism" since World War II? Discuss which you think are the most important and why.
3. Which concepts and techniques are available to aid marketers isolate differences and similarities in domestic and international marketing in order for them to plan appropriate marketing strategies?
4 How do different kinds of environmental factors enable the domestic firm to global?
5 What is joint venture? Why do firms prefer joint venture to go global?

6 What different pricing methods are adopted by firm in international market?

7 What different product development strategies are used by international firms?

8 Explain International Marketing Research in detail.

11.17 References

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Unit - 12 : Foreign Trade Procedures

Unit Structure

12.0 Objectives

After studying this unit you will be able:

- To understand the nature and concept of foreign trade procedures.
- To understand the various commercial terms related with the entire process.
- To understand the simplified process of export and import.
- To study the different financing techniques used commonly for the foreign trade.
- To gain an insight into the various promotional schemes for the export growth.

12.1 Introduction

Foreign trade is considered as the most significant determinant of economic development of a country. We will disucss the following foreign Trade laws of India: Foreign Trade (Development & Regulation) Act, 1992 Payments for import and export transactions governed by Foreign Exchange Management Act, 1999, Customs Act, 1962 governs the physical movement of goods and services through various modes of transportation. Exports (Quality control & inspection) Act, 1963. In order to deal with the changing requirements of the business globally, it is essential that the framework remains flexible and adaptable to absorb the anticipated changes.

12.2 Import and Export Procedure

We will now describes the sequence of the Export-Import procedure:

Step 1: Trade Inquiry

First of all, the importer makes an inquiry from various exporters. For this he sends a letter of inquiry to the exporter, laying query regarding availability and terms and conditions of delivery and payment.

In the letter of inquiry the importer must state the quality, quantity and description of the goods desired. In reply to the inquiry the importer will receive a quotation from the exporter.

Step 2: Procurement of Import-Export License

Any person who wants to be in the business of import-export of goods is required to obtain a license for the same, unless the goods to be imported are exempt from license.

Major formalities in export-import business are to get an Importer-Exporter code number, which is, required for foreign exchange. It is also known as form of declaration, V.P. code. If we export-import from India then we need to have an importer-exporter code number, which is issued, by the regional office of the Directorate General of Foreign Trade (DGFT). Custom authority will not allow import-export of goods from India without having IEC code Number.

Step 3: Offers and Order Placement

Export business start with a document written by exporter to importer. This is known as quotation. The quotation states the price at which the goods will be supplied. It contains the particulars like quantity, quality of goods available etc.

If the offer is acceptable to the buyer in terms of price, delivery and payment terms, the buyer will then place an order on the exporter.

Step 4: Order Acceptable

It is advisable that the Exporter acknowledges the receipt of the order, giving a schedule for the delivery.

Step5: Obtaining Foreign Exchange

After accepting the order the importer has to submit an application in the prescribed form along with the import license to any foreign exchange bank. The exchange bank will forward the application to exchange control department of Reserve Bank of India. After examining the application in accordance with exchange policy of the government, RBI will sanction the release of foreign exchange. The intending importer will get the amount of foreign exchange from the exchange bank concerned.

Step 6: Sending Letter of Credit

In case the importer does not enjoy full confidence of the exporter, he has to give a proof. For this purpose he may send a letter of credit to foreign supplier. The importer can obtain letter of credit (L/C) by depositing the amount of money in the bank. A L/C contains an undertaking by the bank to honor bill of exchange drawn by the exporter on the importer up to the amount specified in L/C.

Step 7: Documents for C & F Agent

The exporter is expected to provide the following documents to the Clearing & Forwarding Agents, who are entrusted with the task of shipping the consignments, either by air or sea:

1. Invoice.
2. Packing List.
3. Declaration in SDF (to meet requirements as per Foreign Exchange Management Act, 1999 (FERA) in duplicate.
4. AR4- first and second copy.
5. Any other declaration, as required by customs.

On account of the introduction of Electronic Data Interchange (EDI) system for processing shipping bills electronically at most of the location- both for air or sea consignments- the C & F Agents are required to file with Customs the shipping documents, through a particular format, which will vary depending on the nature of the shipment. Broad categories of export shipment are:

- o Under claim of Drawback of duty.
- o Without claim of Drawback.
- o Export by a 100% Export Oriented Units (EOU)
- o Under DEPB scheme.

Step 8: Customs Clearance

After assessment of the shipping bill and examination of the cargo by Customs (where required), the export consignments are permitted by Customs for ultimate Export. This is what the concerned Customs officials call the 'LET EXPORT' endorsement on the shipping bill. Importer or his agent waits for the arrival of the ship. When the ship arrives at the port of destination, the importer makes arrangement for clearing of goods. For this purpose he has to comply with the following formalities:

- Delivery Order- First of the importer has to obtain the delivery order from the shipping company.
- Port Trust Dues Receipt- In order to take delivery of the goods, the importer has to pay a charge, which is collected on all goods entering the boundaries of the country.
- Bill of Entry- It is document certifying
    - Name and Address of the importer
    - Import license Number.
    - Port of Destination.
    - Name of Ship and no.
    - Name of the country where the goods are to be imported.
    - Custom Duty payable.
    - Package no. & mark.
    - Description of the goods in terms of their quality & quantity.

Step 9: Document Forwarding

After completing the shipment formalities, the C & F Agents are expected to forward to the Exporter the following documents;

- Customs signed Export Invoice & packing List.
- Duplicate of Form SOP (Standard Operating Procedure).
- Exchange control copy of the shipping Bill, processed electronically.
- Bill of Lading or Airway bill as the case may be.

10. Step 10: Shipment Notification to Importer

Now exporter prepares an invoice of goods in which he writes name of ship, description of goods, quality, price, ship charges, postage, insurance and commission paid etc. and forward to importer.

11. Step 11: Making Payment

The import trade procedure comes to end when the importer makes the payment to the exporter. Unless payment for the goods in advance. The importer may send payment as a contract of export order likewise:

(1) Payment against document.
(2) Payment against Delivery.
(3) Payment in Advance.
(4) Payment under open account.

(5) Payment under Letter of Credit.

(6) Payment on Consignment Basis.

12. Step12: Delivery of Goods

After completing necessary formalities the importer present the delivery order to the officer of the dock. The officer signs the delivery order and issues a gate pass. The importer submits the delivery of goods then he makes arrangement for carrying the goods by rail or road transport to his factory.

12.3 Payment Terms, Documentation and Financing Techniques

(A) Payment Terms:

There following are the five principal means of payment that are resorted to in the context of foreign trade:

1. **Cash in advance (CIA)** - A method of payment for goods whereby the buyer pays the seller prior to shipping the goods. The features of CIA are as below:
   - There is minimal risk to exporter
   - It is used where there is

     a. Political unrest
     b. Goods made to order
     c. New unfamiliar customer

2. **Letter of Credit (L/C) -** A document issued by a bank per instructions by a buyer of goods authorizing the seller to draw a specified sum of money under specified terms. Issued as revocable or irrevocable. The features of L/C are as below:

   a. Written and signed by buyer's bank
   b. Promising to honor seller's drafts.
   c. Bank substitutes its own commitment
   d. Seller must conform to terms
   e. Advantages of an L/C to Exporter
      - Eliminates credit risk
      - Reduces default risk
      - Payment certainty
      - Prepayment risk protection
      - Financing source

   f. Advantages of L/C to Importer
      - Shipment assured
      - Documents inspected
      - May allow better sales terms
      - Relatively low-cost financing
      - Easy cash recovery if discrepancies

3. **Drafts -** An unconditional order in writing from one person (the Drawer) to another (the Drawee), directing the Drawee to pay a specified amount to a named drawer on presentation (sight draft) or on a fixed date in future (time draft). The functions of draft are as follows:

- Clear evidence of financial obligation
- Reduced financing costs
- Provides negotiable and unconditional financial instrument (ie. may be converted to a banker's acceptance)

4. **Consignment -** Delivery of merchandise from an exporter (consignor) to an agent (consignee) under agreement that the agent sells the merchandise for the account of the exporter. The basic features of consignment are enumerated as follows:
    - Exporter = the consignor
    - Importer = the consignee
    - Consignee attempts to sell goods to a third party; keeps some profit, remits rest to consignor
    - Use: Between affiliates

5. **Open Account** - A trade arrangement in which goods are shipped to a foreign buyer without guarantee of payment such as a note, L/C, or other formal written evidence of indebtedness. The basic features of Open Account are as below:
    a. Creates a credit sale
    b. To importer's advantage
    c. More popular lately because
        - Major surge in global trade
        - Credit information improved
        - More global familiarity with exporting.
    d. Benefits of Open Accounts:
        - Greater flexibility in making a trade
        - Lower transactions costs
    e. Major disadvantage: highly vulnerable to government currency controls.

6. **Bill of Exchange -** When a draft is drawn on a foreign bank, it is known as bill of exchange. It means collecting payment from the foreign buyer through the banking channel. It is also a method of extending credit

(B) Documents:

There are four commonly used documents that are used in the procedure for import and export. They are as follows:

1. **Bill of Lading -** A document that establishes the terms of a contract between a shipper and a transportation company under which freight is to be moved between specified points for a specified charge. The basic features are as follows:
    - A receipt for the goods delivered to the carrier for shipment.
    - Acts as a contract to carry the goods.
    - A Document of Title to the goods described therein.
    - This document is generally not negotiable unless consigned "to order."

2. **Commercial Invoice –** It is a receipt for a transaction and or goods purchased (invoice) indicating the sender or seller and the receiver or purchaser. A commercial invoice should contain an itemized list of the merchandise with the complete description of goods with their unit value and extended total value. Depending on the Customs requirements of the destination country, there may be additional requirements, statement or clauses that must appear as well. The basic features include:

- Lists full details of goods shipped
- Names of importer/exporter given
- Identifies payment terms
- List charges for transport and insurance.

3. **Insurance** – The basic features are as follows:
   - There are two categories of insurance two categories namely:
     a. Marine:transport by sea
     b. Air: transport by air
   - The insurance certificate is issued to show the proof of insurance.
   - All shipments insured today.

4. **Consular Invoice -**

A document required by some countries describing a shipment of goods and showing information such as the consignor, consignee, and value of the shipment. Certified by a consular official, a consular invoice is used by the country's customs officials to verify the value, quantity, and nature of the shipment.

Local consulate in host country issues:

- A visa for the exporter's invoice
- Requires fee to be paid to consulate

(C) Financing Techniques:

There are four types of financing techniques commonly used in process of import and export. These are as follows:

1. Bankers' Acceptances
   - Creation: drafts accepted
   - Terms: Payable at maturity to holder

2. Discounting
   - Converts exporters' drafts to cash minus interest to maturity and commissions.
   - Low cost financing with few fees
   - May be with (exporter still liable) or without recourse (bank takes liability for non-payment).

3. Factoring – The firms sell accounts receivable to another firm known as the factor.
   - Discount charged by factor
   - Non-recourse basis: Factor assumes all payment risk.
   - It is used when:

     1.) The case is of occasional exporting

     2.) The clients are geographically dispersed.

4. Forfeiting – It is discounting at a fixed rate without recourse of medium-term accounts receivable denominated in a fully convertible currency. The features are:

- Use: Large capital purchases
- Most popular in W. Europe

12.4 EXIM Procedures Simplified

(A) Import Procedure

1. **E filing of documents:** Goods should arrive at customs port/airport only. Most of customs procedures are computerized. E filing of documents is required.

2. **Import manifest or Import Report:** 'Person in charge of conveyance' is required to submit Import Manifest or Import Report.

3. **Entry Inwards:** Goods can be unloaded only after grant of 'Entry Inwards'.

4. **Risk Management System:** Self-Assessment on basis of 'Risk Management System' (RMS) has been introduced in respect of specified goods and importers.

5. **Bill of Entry** for home consumption on payment of customs duty: Importer has to submit Bill of Entry giving details of goods being imported, along with required documents. Electronic submission of documents is done in major ports.

   White Bill of Entry is for home consumption. Imported goods are cleared on payment of customs duty.

6. **Bill of Entry for warehousing:** Yellow Bill of Entry is for warehousing. It is also termed as 'into bond Bill of Entry' as bond is executed. Duty is not paid and imported goods are transferred to warehouse where these are stored. Green Bill of Entry is for clearance from warehouse on payment of customs duty. It is for ex-bond clearance.

7. **Noting, examination and assessment:** Bill of Entry is noted, Goods are assessed to duty, examined and pre-audit is carried out. Customs duty is paid after assessment.

8. **Bond:** Bond is executed if required if assessment is provisional (PD bond) or concessional rate of customs duty is subject to certain post import conditions.

9. **Out of customs charge order:** Goods can be cleared outside port after customs officer issues 'Out of Customs Charge' orders. After that, port dues, demurrage and other charges are paid and goods are cleared.

10. **Demurrage if clearance from port delayed:** Demurrage is payable if goods are not cleared from port/airport within three days. Goods can be disposed of if not cleared from port within 30 days.

(B) Export Procedure

1. **Entry Outward:** Loading in conveyance can start after customs officer gives 'Entry Outward'.

2. **Export manifest/Export report**: Person in charge of conveyance is required to submit 'Export Manifest' or 'Export Report'.

3. **Registration with DGFT and EPC:** Exporter has to be obtain IEC number from DGFT is advance. He should be registered with Export Promotion Council if he intends to claim export benefits.

4. **Third party exports:** Export can be by manufacturer himself or third party (i.e. by exporter on behalf of another). Merchant exporter means a person engaged in trading activity and exporting or intending to export goods.

5. **Registration of documents under** Export Promotion Scheme: Advance authorization, DEPB etc. should be registered if exports are under Export Promotion Scheme.

6. **Shipping Bill:** Export is required to submit Shipping Bill with required documents for obtaining permission to export. There are five forms : (*a*) Shipping Bill for export of goods under claim for duty drawback - these should be in Green colour (*b*) Shipping Bill for export of dutiable goods - this should be yellow color (*c*) Shipping bill for export of duty free goods - it should be white color (*d*) shipping bill for export of duty free goods ex-bond - i.e. from bonded store room - it should be pink color (e) Shipping Bill for export under DEPB scheme - Blue color.

7. **FEMA formalities:** GR/SDF/SOFTEX form (under FEMA) is required to be submitted.

8. **Noting, assessment, and examination:** The shipping bill is noted, goods are assessed and examined. Export duty is paid, if applicable.

9. **Certification of documents for export incentives:** If export is under export incentives, relevant documents are checked & certified. Then proof of export is obtained on ARE-1.

10. **Let export order:** Conveyance can leave only after 'Let Export' order is issued.

12.5 Export Promotion

Export promotion includes incentive programmes designed to attract more firms into exporting by offering help in product and market identification and development, pre-shipment and post-shipment financing, training, payment guaranty schemes, trade fairs, trade visits, foreign representation, etc. Sustained export growth is crucial for maintaining and accelerating the GDP growth momentum, increasing employment and alleviating poverty. Since full liberalization of imports and sharp reduction in transaction costs were expected to take time to implement, several export promotional schemes were introduced in the last two decades.

It is the view that a export strategy must rest upon two basic premises. Firstly, to be competitive in the international market, the export product must match, if not better, the competition in terms of pricing and quality. Secondly, the exporter must have an incentive to enter the highly uncertain export market. Both these objectives are achieved through wide-ranging facilities, infrastructure, financing, tax relief, trade facilitation, etc. and indirect taxes play a critical role. Taking up indirect taxes, it is evident that the strategy so far has been to grant customs and central excise duty exemptions on the raw materials, inputs etc. used in the export product. Particularly on the customs side this leads to making available the international high quality raw materials, inputs etc. at the international price and our exporters are thus not disadvantaged viz. a viz. their competitors abroad. Moreover it ensures that the price of the export product is not loaded with any tax element.

Neutralizing the tax element in export products is an internationally accepted methodology to encourage exports. However, multiple schemes cause difficulties in administration and are liable for some misuse. Accordingly, on a comprehensive review of the present schemes and taking into regard all relevant factors and the best international practices it is recommended that the export strategy should focus upon the following schemes:

(i) SEZ and EOU schemes – This is for the grant of duty exemption on all goods (capital goods, raw materials etc.) required by the units for their export production.

(ii) Advance Licensing (actual user) scheme - This would grant duty exemption to actual users on capital goods, raw materials etc. used for export production subject to post-clearance intelligence and audit-based verification.

(iii) Drawback scheme – Here, the relief from duties on the inputs, raw materials, capital good etc. would be provided through a mechanism of refund of the duties paid. Export promotion strategies

Export promotion strategies are part of trade promotion and should focus on enterprise & industry, and national levels.

(a) Enterprise Level

Some parts of the business community in developing countries have been unable to significantly increase export volumes on their own for the following reasons:

(i) A limited number of commodities are available for export, so export sectors depend on international developments affecting the world market.

(ii) Industrial production of goods is limited by the lack of downstream activities, which does not allow enterprises to produce differentiated products for export or provide some form of export diversification.

(iii) There is dependence on one or two key export markets and supply sources, and this does not give enterprises an opportunity to develop products according to the standards of more developed markets. This also results in lack of knowledge about marketing abroad.

(iv) Enterprises lack export readiness, which might be due to unwillingness to venture overseas because the domestic market offers comfort and security.

However, the transition to a market economy may force enterprises to look beyond the domestic market in order to earn much-needed foreign exchange and generate employment. International marketing is a much more complicated process than marketing and selling in a domestic economy. Transitional economies need a lead agency to drive the effort towards becoming exporters.

(b) Industry Level.

Increasing the exports of existing products means looking at what industries currently produce for export to the world market. For many transitional and emerging economies, exports are mainly commodity and primary products. Therefore an initial export strategy should focus on enhancing and consolidating the volume of export into existing markets as well as diversifying to other exports markets.

The second dimension involves making an assessment of what new products could be developed for export markets. These new products often originate from spin-offs or downstream activities from existing core industries. For example, the oil industry supports petrochemical industries and oil equipment manufacturing. Therefore, governments could help develop an industry to become ready overall for exporting through industrial cluster planning. Industry councils or associations can play a major role by advising and working with the government or its designated trade body to develop export strategies. These strategies should be

based on comprehensive study of the export potential for select products. This will involve:

(i) Clear identification of what is produced, planned production in the near future and the most suitable markets for such products;

(ii) Concurrent study of what is being purchased in foreign markets in order to suggest what could be produced in the country to satisfy the needs and opportunities of foreign markets;

(iii) Clear indication of constraints or problems for exports in terms of production or market conditions, which should lead to recommendations about how to solve problems or counteract any constraints.

(c) National Level

The government sets the overall economic direction and trade development strategy. Establishing the export dimension of this strategy in terms of appropriate economic instruments and export promotion measures is critical to national export performance. Therefore, the design of relevant trade policies is the key to a successful national export promotion programme.

Export Incentives

The Government of India has framed several schemes to promote exports and to obtain foreign exchange. These schemes grant incentive and other benefits. The few important export incentives, from the point of view of indirect taxes are briefed below:

1. **Free Trade Zones (FTZ)**

   Several FTZs have been established at various places in India like Kandla, Noida, Cochin, etc. No excise duties are payable on goods manufactured in these zones provided they are made for export purpose. Goods being brought in these zones from different parts of the country are brought without the payment of any excise duty. Moreover, no customs duties are payable on imported raw material and components used in the manufacture of such goods being exported. If entire production is not sold outside the country, the unit has the provision of selling 25% of their production in India. On such sale, the excise duty is payable at 50% of basic plus additional customs or normal excise duty payable if the goods were produced elsewhere in India, whichever is higher.

2. **Electronic Hardware Technology Park / Software Technology Parks**

   This scheme is just like FTZ scheme, but it is restricted to units in the electronics and computer hardware and software sector.

3. **Advance License / Duty Exemption Entitlement Scheme (DEEC)**

   In this scheme advance license, either quantity based (Qbal) or value based (Vabal), is given to an exporter against which the raw materials and other components may be imported without payment of customs duty provided the manufactured goods are exported. These licenses are transferable in the open market at a price.

4. Export Promotion Capital Goods Scheme (EPCG)

   According to this scheme, a domestic manufacturer can import machinery and plant without paying customs duty or settling at a concessional rate of customs duty. But his undertakings should be as mentioned below:

Customs Duty Rate	Export Obligation	Time
10%	4 times exports (on FOB basis) of CIF value of machinery.	5 years
Nil in case CIF value is Rs200mn or more.	6 times exports (on FOB basis) of CIF value of machinery or 5 times	

	exports on (NFE) basis of CIF value of machinery.	8 years
Nil in case CIF value is Rs50mn or more for agriculture, aquaculture, animal husbandry, floriculture, horticulture, poultry and sericulture.	6 times exports (on FOB basis) of CIF value of machinery or 5 times exports on (NFE) basis of CIF value of machinery.	8 years

5. Deemed Exports

The Indian suppliers are entitled for the following benefits in respect of deemed exports:

- Refund of excise duty paid on final products
- Duty drawback
- Imports under DEEC scheme
- Special import licenses based on value of deemed exports

The following categories are treated as deemed exports for seller if the goods are manufactured in India:

- o Supply of goods against duty free licences under DEEC scheme
- o Supply of goods to a 100 % EOU or a unit in a free trade zone or a unit in a software technology park or a unit in a hardware technology park
- o Supply of goods to holders of licence under the EPCG scheme
- o Supply of goods to projects financed by multilateral or bilateral agencies or funds notified by the Finance Ministry under international competitive bidding or under limited tender systems in accordance with the procedures of those agencies or funds where legal agreements provide for tender evaluation without including customs duty
- o Supply of capital goods and spares upto 10% of the FOR value to fertilizer plants under international competitive bidding
- o Supply of goods to any project or purpose in respect of which the Ministry of Finance permits by notification the import of goods at zero customs duty along with benefits of deemed exports to domestic supplies
- o Supply of goods to power, oil and gas sectors in respect of which the Ministry of Finance permits by notification benefits of deemed exports to domestic supplies

6. Manufacture Under Bond

This scheme furnishes a bond with the manufacturer of adequate amount to undertake the export of his production. Against this the manufacturer is allowed to import goods without paying any customs duty, even if he obtain it from the domestic market without excise duty. The production is made under the supervision of customs or excise authority.

7. Duty Drawback

It means the rebate of duty chargeable on imported material or excisable material used in the manufacturing of goods in and is exported. The exporter may claim drawback or refund of excise and customs duties being paid by his suppliers. The final exporter can claim the drawback on material used for the manufacture of export products. In case of re-import of goods the drawback can be claimed.

The following are Drawbacks:

- Customs paid on imported inputs plus excise duty paid on indigenous imports.
- Duty paid on packing material.

Drawback is not allowed on inputs obtained without payment of customs or excise duty. In part payment of customs and excise duty, rebate or refund can be claimed only on the paid part.

In case of re-export of goods, it should be done within 2 years from the date of payment of duty when they were imported. 98% of the duty is allowable as drawback, only after inspection. If the goods imported are used before its re-export, the drawback will be allowed as at reduced percent.

8. Export Credits

Export credit is providing pre-shipment and post-shipment credit either in Indian rupees or in foreign currency to an exporter. The credit is given for short term i.e. upto 6 months, medium/ long term which extends more than 6 months according to the eligibility of the products and projects. Usually medium/long term export credit is given after inspecting the supplier's credits.

To promote the export promotion drive, the Government of India established Export Credit Guarantee Corporation of India Limited (ECGC) in 1957 to cover the risk of exporting on credit. This organization offers a range of services to exporters. They are as mentioned below:

- It provides credit risk insurance covers to the exporters against there loss in export of goods and services.
- It offers guarantees to the banks and financial institutions in order to enable the exporters to obtain better facilities from them.
- It provides Overseas Investment Insurance to the Indian companies investing in joint ventures abroad as equity of loan.

9. Export Credit Insurance

Export credit insurance protects the exporter from the consequences of the payment risks due to the far-reaching political and economic changes. Outbreak of war or civil war might block or delay the payment for goods already exported.

(i) Standard policies to protect the exporter against the risk of not receiving the payment while trading with overseas buyers on short-term credit.

(ii) Specific policies which is designed to protect the exporter against the risk of not receiving the payment in respect of:

  - Exports on deferred payment terms
  - Services rendered to the foreign parties

12.6 International Commercial Terms (INCOTERMS)

The Incoterms rules or International Commercial terms are a series of pre-defined commercial terms published by the International Chamber of Commerce (ICC) and widely used in international commercial transactions. They are a series of three-letter trade terms related to common sales practices. The Incoterms rules aim mainly to clearly communicate the tasks, costs and risks associated with the transportation and delivery of goods. The Incoterms rules are accepted by governments, legal authorities and practitioners worldwide for the interpretation of most commonly used terms in international trade. They are intended to reduce or remove uncertainties arising from different interpretation of the rules in different countries. "Incoterms" is a registered trademark of the ICC.

In 1936, the first set of the Incoterms rules was published. The first set remained in use for almost 20 years before the second publication in 1953. Additional amendments and expansions followed in 1967, 1976, 1980, 1990 and 2000. The eighth and current version of the Incoterms rules—Incoterms 2010—was published on January 1, 2011.

The current International Commercial Terms in practice worldwide are as follows:

A. Rules for Any Mode(s) of Transport - There are seven rules in this category;

1. EXW – Ex Works (named place of delivery)

   The seller makes the goods available at its premises. This term places the maximum obligation on the buyer and minimum obligations on the seller. The Ex Works term is often used when making an initial quotation for the sale of goods without any costs included. EXW means that a seller has the goods ready for collection at his premises (works, factory, warehouse, plant) on the date agreed upon. The buyer pays all transportation costs and also bears the risks for bringing the goods to their final destination. The seller doesn't load the goods on collecting vehicles and doesn't clear them for export. If the seller does load the good, he does so at buyer's risk and cost. If parties wish seller to be responsible for the loading of the goods on departure and to bear the risk and all costs of such loading, this must be made clear by adding explicit wording to this effect in the contract of sale.

2. FCA – Free Carrier (named place of delivery)

   The seller hands over the goods, cleared for export, into the disposal of the first carrier (named by the buyer) at the named place. The seller pays for carriage to the named point of delivery, and risk passes when the goods are handed over to the first carrier.

3. CPT - Carriage Paid To (named place of destination)

   The seller pays for carriage. Risk transfers to buyer upon handing goods over to the first carrier.

4. CIP – Carriage and Insurance Paid to (named place of destination)

   The containerized transport/multimode equivalent of CIF. Seller pays for carriage and insurance to the named destination point, but risk passes when the goods are handed over to the first carrier.

5. DAT – Delivered at Terminal (named terminal at port or place of destination)

   Seller pays for carriage to the terminal, except for costs related to import clearance, and assumes all risks up to the point that the goods are unloaded at the terminal.

6. DAP – Delivered at Place (named place of destination)

   Seller pays for carriage to the named place, except for costs related to import clearance, and assumes all risks prior to the point that the goods are ready for unloading by the buyer.

7. DDP – Delivered Duty Paid (named place of destination)

   Seller is responsible for delivering the goods to the named place in the country of the buyer, and pays all costs in bringing the goods to the destination including import duties and taxes. This term places the maximum obligations on the seller and minimum obligations on the buyer.

(B) Rules for Sea and Inland Waterway Transport - There are four rules defined for international trade where transportation is entirely conducted by water are:

1. FAS – Free Alongside Ship (named port of shipment)

   The seller must place the goods alongside the ship at the named port. The seller must clear the goods for export. Suitable only for maritime transport but not for multimode sea transport in containers. This term is typically used for heavy-lift or bulk cargo.

2. FOB – Free on Board (named port of shipment)

   The seller must load the goods on board the vessel nominated by the buyer. Cost and risk are divided when the goods are actually on board of the vessel. The seller must clear the goods for export. The term is applicable for maritime and inland waterway transport only but not for multimode sea transport in containers. The buyer must instruct the seller the details of the vessel and the port where the goods are to be loaded, and there is no reference to, or provision for, the use of a carrier or forwarder.

3. CFR – Cost and Freight (named port of destination)

   Seller must pay the costs and freight to bring the goods to the port of destination. However, risk is transferred to the buyer once the goods are loaded on the vessel. Maritime transport only and insurance for the goods is not included. This term is formerly known as CNF (C&F).

4. CIF – Cost, Insurance and Freight (named port of destination)

   Exactly the same as CFR except that the seller must in addition procure and pay for the insurance. Used in Maritime transport only.

12.7 Summary

Creation of appropriate institutional framework and supportive environment facilitates the growth of external trade. In a developing country like India, the real barometer of sustained economic development is the growth index of exports. Sustained growth in exports can only be accelerated by conducive framework. The primary objective and emphasis of the framework is towards accelerated development with the required regulation to support the framework structure. The role of regulation is to protect the interests of consumers, obtain conditions of competition and foster the institutional framework. The present regulatory framework in India is highly supportive. The attitude of the government, a very important aspect for faster pace, is poised in that direction to make the framework achieve the sustained growth, removing the bottlenecks, hindering the path of progress and development. Documentation, procedures, financing tools and promotional measures, though complex and cumbersome are an integral part of international marketing operations. They are needed in compliance with either the requirements of contract concluded between exporters and importers, or the requirements of exporting or importing countries.

12.8 Key Words

- **Letter of Credit (L/C) -** A document, issued by a bank per instructions by a buyer of goods, authorizing the seller to draw a specified sum of money under specified terms, usually the receipt by the bank of certain documents within a given time.

- **Foreign Trade Zone (FTZ) -** A port designated by the government for duty-free entry of any non-prohibited goods. Merchandise may be stored, displayed, and used for manufacturing within the zone and re-exported without duties being paid. Duties are imposed only when the original goods or items manufactured from those goods pass from the zone into an area of the country subject to customs authority. Also called a Free Trade Zone.

- **Export License -** A document secured from a government, authorizing a shipper to export a specific quantity of a particular commodity to a certain country. An export license is often required when a government places restrictions upon exports.
- **Date Draft -** A draft that matures in a specified number of days after the date it is issued, without regard to the date of ACCEPTANCE.
- **Consular Invoice -** A document required by some countries describing a shipment of goods and showing information such as the consignor, consignee, and value of the shipment. Certified by a consular official, a consular invoice is used by the country's customs officials to verify the value, quantity, and nature of the shipment.
- **Certificate of Origin -** A document, certifying the country of origin of specified goods.
- **Import License -** A certificate issued by countries exercising import controls that permits importation of the articles stated in the license and often authorizes and/or releases the funds in payment of the importation.
- **Open Account -** A trade arrangement in which goods are shipped to a foreign buyer without guarantee of payment such as a note, L/C, or other formal written evidence of indebtedness.
- **Bill of Exchange -** When a draft is drawn on a foreign bank, it is known as bill of exchange. It means collecting payment from the foreign buyer through the banking channel. It is also a method of extending credit

12.9 Self Assessment Test

1. What is meant by exports and import?
2. Discuss the various steps of export-import procedure.
3. What are the various techniques of financing exports and imports?
4. Write an essay on various measures taken for export promotion.
5. Briefly explain the important stages in procedure of export trade.
6. Write short notes on the following:
    a) Letter of Credit
    b) Bill of Exchange
    c) Bill of Exchange
7. Explain the different commercial terms used in the international trade processes.

12.10 References

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