INTERNATIONAL BUSINESS

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MODULE I

1.0 Introduction to International Business

- **Definition:** According to **Pearson Pathways** "International business focuses on any commercial activity or transaction between companies, organizations, individuals, or government entities that crosses borders into different countries and regions."
- **Meaning**: International business means carrying on business activities beyond national boundaries. These activities normally include the transaction of economic resources such as goods, capital, services (comprising technology, skilled labour, and transportation, etc.), and international production. Production may either involve production of physical goods or provision of services like banking, finance, insurance, construction, trading, and so on. Thus, international business includes not only international trade of goods and services but also foreign investment, especially foreign direct investment.
- International business has been playing a crucial role for centuries. In the present-day world, it has become indispensable. Its role has increased significantly, both at the macroeconomic and microeconomic levels. No country—developed, or developing-produces all commodities to meet its requirements. It needs to import items that are not produced domestically. At the same time, it tries to export all items that are produced over and above its domestic requirements, so that its balance of payments may not worsen in the wake of imports.

Features of International Business

1. **Crossing National Boundaries**: International business involves transactions that cross national boundaries.
2. **Economic Resources**: It includes the transaction of economic resources such as goods, capital, services (including technology, skilled labour, and transportation), and international production.
3. **Involves Production**: The production may involve physical goods or provision of services like banking, finance, insurance, construction, trading, etc.
4. **Includes Trade and Investment**: International business includes not only international trade of goods and services but also foreign investment, especially foreign direct investment (FDI).
5. **Role at Macro and Microeconomic Levels**: It plays a crucial role at both macroeconomic (country level) and microeconomic (firm level) levels.
6. **Foreign Direct Investment (FDI)**: FDI has gained importance in recent times. It is made for a variety of purposes such as acquiring natural resources, recovering expenditure on research and development, capturing a larger segment of the international market, and earning large profits.
7. **Maximising Corporate Wealth**: From the viewpoint of maximising corporate wealth, it is in the interest of a firm to export its product to foreign markets and to capture a large share of the markets abroad, especially when the domestic market is saturated.
8. **Minimising Cost**: In order to minimise the cost and thereby, maintain a competitive edge, a firm likes to import inputs from least-cost locations.
9. **Offshore Assembly Operations**: Components involving capital-intensive mode of production are manufactured in a capital abundant economy and exported to a labour abundant economy for their assembly so that the firm can make use of cheap labour.
10. **Transfer of Technology**: Manufacturing in a foreign location involves not only investment of capital but also the transfer of technology. The transfer of technology helps improve the firm's competitiveness in markets abroad and at the same time is able to recover the huge cost incurred on research and development.

Advantages of International Business

1. **Earning Valuable Foreign Currency:** By exporting goods to other countries, a country can earn valuable foreign currency.
2. **Division of Labor:** International business leads to specialization in the production of goods, improving quality.
3. **Optimum Utilization of Resources:** It reduces waste of national resources and helps each country make optimum use of its natural resources.
4. **Increased Standard of Living:** The sale of surplus production to another country increases the incomes and savings of people in the exporting country, raising their standard of living.
5. **Benefits to Consumers**: Consumers benefit from a variety of better quality goods available at reasonable prices.
6. **Encouragement to Industrialization:** Exchange of technological know-how enables underdeveloped and developing countries to establish new industries.
7. **International Peace and Harmony:** International business removes rivalry between different countries and promotes international peace and harmony.
8. **Cultural Development:** International business fosters the exchange of culture and ideas between countries.
9. **Economies of Large-Scale Production:** International business leads to production on a large scale because of extensive demand.
10. **Stability in Prices:** International business irons out wide fluctuations in the prices of products.
11. **Widening the Market**: International business widens the market for products all over the world.
12. **Advantageous in Emergencies:** International business enables us to face emergencies. In the case of natural calamity, goods can be imported to meet necessities.
13. **Accessing New Talent:** International business allows companies to access a greater talent pool.
14. **Increased Revenues:** Companies trading internationally often have higher revenues than those trading domestically.

Disadvantages of International Business

1. **Impediment in the Development of Domestic Industries**: International trade can have an adverse effect on the development of domestic industries due to foreign competition, cheaper availability, and unrestricted imports.
2. **Difficulties in Times of Need**: Dependence on foreign goods can create difficulties in times of war or other emergencies when the country is cut off by enemy action.
3. **Use of Monopoly to Control Price**: The exploitation of the importing country by the exporting country can take place. For example, crude oil cannot be produced by every country and that is the reason why crude importing countries are at a disadvantage all the time due to the near monopoly of oil exporting nations.
4. **Economic Dependence**: The underdeveloped countries have to depend upon the developed ones for their economic development, which may lead to economic exploitation.
5. **Widening Trade Gap**: The gains from trade are not equally distributed. Developing Countries which sell primary commodities and buy manufactured goods in return from the developed countries are the losers. Thus trade balance remains in favor of developed countries.
6. **Over Utilization of Natural Resources**: Excessive exports may exhaust the natural resources of a country in a shorter span of time than it would have been otherwise.
7. **Political Risk**: Different countries provide their own political risks at varying levels, while domestic political changes over time and present an ongoing challenge.
8. **Heavy Opening and Closing Cost**: Starting a business requires a lot of money. Similarly, closing a business also involves significant costs.
9. **Foreign Rules and Regulations**: Doing business in another country requires a company to follow a lot of rules and regulations.
10. **Language Barrier**: Different countries have varying languages and cultures, which can pose a challenge for international businesses.
11. **Currency Risk**: Fluctuations in currency exchange rates can impact the profitability of businesses.

12. **Destruction of Home Industry**: International business may discourage the growth of indigenous industry.
13. **Import of Harmful Goods**: International business may lead to import of luxurious goods, spurious goods, dangerous goods, etc. It may harm the well-being of people.
14. **Setup or Entrance Costs and Shutting Down or Exit Costs**: Paying for office infrastructure (such as rent and utilities), any regulatory fees and the salaries of your workers, be they from home or abroad all add up.

Differences between International Business and Domestic Business

Aspect	**Domestic Business**	**International Business**
Transactions	Limited to the length and breadth of the country.	Involves across-the-country transactions or across-the-country production or provision of services.
Complexity	Less complex as it deals with a single set of economic, cultural, and legal systems.	More complex due to the need to deal with multiple sets of economic, cultural, and legal systems.
Intra-firm Transactions	Less common.	More common, often involving transfer pricing to reduce tax and tariff burdens.
Environment	Deals with a familiar environment.	Deals with varying environments—political, legal, economic, socio-cultural and ethical—in host countries.
Risk	Lower risk as it is not exposed to political risk and exchange rate risk.	Higher risk due to exposure to political risk and exchange rate risk, sometimes leading to financial risk.
Strategy	Strategy is based on domestic market conditions.	Varying strategies of business are adopted in different host countries.
Conflict Management	Less likely to face conflicts related to cultural, social, or economic differences.	More likely to face conflicts if the company's strategy is not in conformity with the political, social, or economic environment of a particular host country.
Management Function	Management functions are based on domestic conditions.	The management function in international business regarding finance and accounting, personnel, marketing, and production differs from that in domestic business.

Need for International Business

- **More and more firms around the world are going global, including:**
  - Manufacturing firms.

- Service companies (i.e. banks, insurance, consulting firms)
- Art, film, and music companies.

- ***Factors Contributing to Rapid Growth of International Business:***
  - Increase in and expansion of technology.
  - Liberalization of cross-border trade and resource movements
  - Development of services that support international business.
  - Growing consumer pressures.
  - Increased global competition.
  - Changing political situations.
  - Expanded cross-national cooperation.
- ***Reasons That Firms Engage in International Business:***
  - To expand sales
  - **To acquire resources:**
    - Products, components, services.
    - Foreign capital.
    - Technologies.
    - Information.
  - **To minimize risk:**
    - Take advantage of business cycle differences amongst countries
    - Diversify suppliers across countries.
    - Counter competitors' advantages.

2.0 Internationalisation Approaches and Forms

What is Internationalisation?

Internationalisation is the process of a company branching out to foreign markets to capture a greater market share. The trend towards internationalisation contributes to globalisation- the state where economies worldwide become integrated due to cross-boarder trade and investments. Internationalisation may require companies to adapt their product features and branding to match the cultural and technological needs of the local market.

An enterprise has many possibilities for internationalization of its business, from the simplest and least risky operations to a total commitment of the company on foreign markets. In our opinion, the relationship between the degree of involvement of the enterprise abroad (in terms of financial, human, material resources and managerial knowledge and invested time) and the risk level of internationalization (in terms of profitability, risk of loss of investment through nationalization, etc.) is linear upwards, as shown in Fig 1.

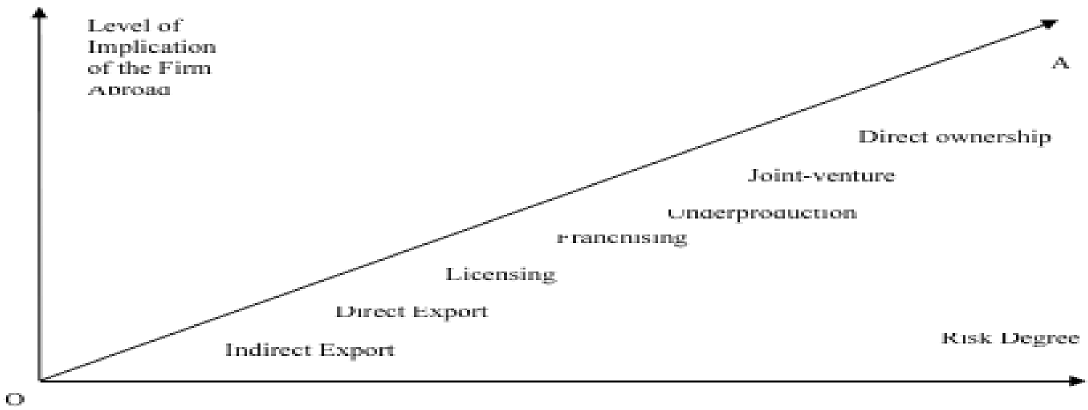


Fig. 1: The process of Internationalization in Development

Drivers for Internationalisation:

Four main reasons for a business to expand its operations abroad are-

- **Achieve growth:** The local market may have a limited customer base or become saturated over time, expanding overseas is the only for businesses to increase their market share and continue growing.
- **Improve profitability:** International businesses can take advantage of marketing and technological advantages in the host country or introduce higher prices to new customers to achieve higher profits.
- **Spread the risk:** By going international, the business can lessen its redundancy on one market or customer base. In case of a market failure or a shift in customer behaviour, it can still rely on other operations elsewhere for survival.
- **Increase competitiveness:** Companies operating overseas have greater economies of scale to lower the cost of their business and be more competitive. The presence on a global scale also boosts the company's reputation and allows it to attract more customers compared to local businesses.

Stages of Internationalisation:

These are the various stages of internationalisation which is explained below-

- Domestic company
- International company
- Multinational company
- Global company
- Transitional company

Domestic company: A domestic company is a company that conducts its affairs in its home country or within the country's geographical boundaries. A domestic business is often taxed differently than a non-taxed domestic business and may be required to pay duties or fees on the products it imports.

Most international companies have their origin as domestic companies. The orientation of a domestic company essentially is ethnocentric. A purely domestic company operates domestically because it never considers the alternative of going international.

The growing stage one company, when it reaches growth limits in its primary market, diversifies into new markets, and product technologies instead of focusing on penetrating international markets.

International company: An international company has business outside the original country where it is located. It is the one that sells products or services in other countries but operates only in its home country.

International company is normally the second stage in the development of a company towards the transitional corporation. The orientation of the company is basically ethnocentric and the marketing strategy is an extension.

The marketing mix developed for the home market is extended into foreign markets. International companies normally rely on international business.

Multinational company: These are those companies who register themselves in their home country but operate in all the other countries of the world through their network of branches and subsidies.

When the orientation shifts from ethnocentric to polycentric, the international company becomes multinational. In other words, when a company decides to respond to market differences, it evolves into a stage three multinational that pursues a multi domestic strategy.

MNCs being the most important vehicle of IB

- Operate at least in six countries
- Involve themselves greatly in host countries
- Are linked through common ownership
- Draw upon a common pool of resources
- Respond to a common strategy

Global company: A global company is a company that operates facilities in many countries around the world.

The global company will have either a global marketing strategy or global sourcing strategy but not both. It will either focus on global markets and source from the home or a single country to supply these markets, or it will focus on the domestic market and source from the world to supply its domestic channel.

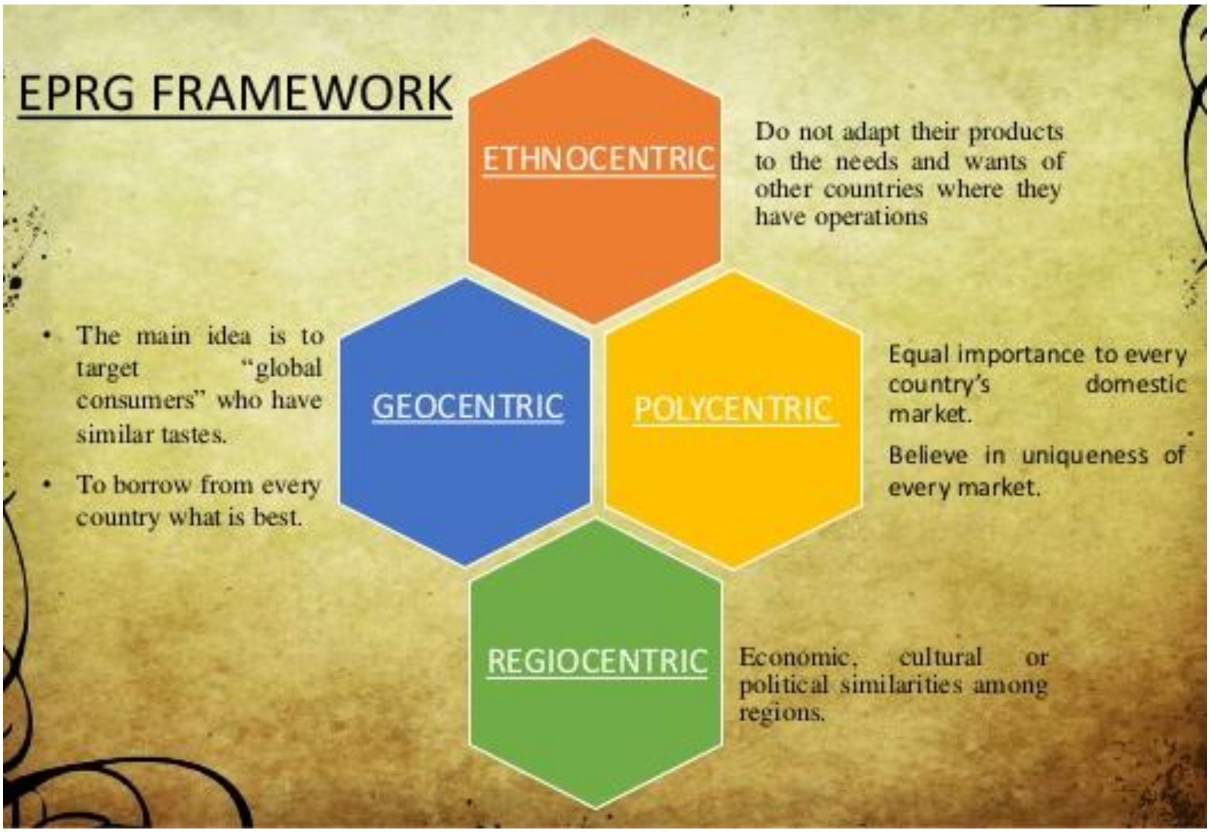
However, according to the interpretation of some others, all strategies for product development, product marketing etc. will be global in respect of the global corporation.

Transitional corporation: It is an enterprise that controls assets of other entities in economies other than its home economy, usually by owning a certain equity capital stake.

The transitional corporation is much more than a company with sales, investments, and operations in many countries. This company, which is increasingly dominating markets and industries around the world, is an integrated world enterprise that links global resources with global markets at a profit.

- **Characteristics of a Transnational Corporation**
  - Geocentric orientation.
  - Thinks globally and acts locally.
  - Global strategy but allows value addition to the customer.
  - Allows adaptation to add value to its global offer.
  - Assets are distributed throughout the world.
  - Independent and specialized.
  - R&D integrated.
  - Production spread but specialized and integrated.

3.0 EPRG FRAMWWORK



EPRG stand for Ethnocentric, Polycentric, Regiocentric and Geocentric. It is a framework that is designed to be used in internationalisation process of businesses and mainly addresses how companies view international management orientations.

Ethnocentric approach- This approach or home country orientation is the approach where a company simply markets its product or services internationally in the same manner as they do domestically.

Companies prefer an ethnocentric approach in order to avoid the expense of developing new marketing techniques to serve foreign consumers.

Polycentric approach- Companies go for customization for each foreign market. The marketing mix developed for the home market is extended into foreign markets. International companies normally rely on international business.

They will customize the products according to each country depending upon the consumers taste or preferences or cultural or any legal or political factors i.e. depending upon their local marketing conditions and then enter into that market.

Regiocentric approach- Company's target a group of countries having similar market characteristics, and then enter into the market.

Once the company is established in various markets, attempts are made to form market clusters based on geographical and psychic proximity.

The production and distribution of products are made to serve the whole region with an effective economy of operation, close control and coordination.

Geocentric approach- The company identifies the needs of consumers worldwide and then enters into the market with standard products with standardized marketing mix for all the markets it serves.

Companies have to identify the similarities in consumption patterns that can be targeted.

International Business Managers

International Business Managers should have the knowledge and the skills to manage and handle cross-cultural processes, stakeholders, the capability to conduct transactions that may involve multiple currencies and environments in a right way.

- **Must understand the importance of:**
  - Domestic and international law.
  - Political science.
  - Sociology.
  - Psychology.
  - Economics.
  - Geography.
- Must be knowledgeable about the competitive dimensions of the international business environment.

4.0 Globalization and Factor causing Globalization of business

Globalization is the process of increased interconnectedness and integration of economies, societies, cultures, technologies, and governance systems across the world, facilitated by advancements in transportation, communication and technology. It involves the flow of goods, service, capital, information, ideas and people across national Broders, leading to greater economic, cultural, political and social interactions on a global scale.

Factors causing Globalization of business

- **Technological change:**

More powerful computers and internet have allowed the easy transfer of data which plays an important role in speeding up the globalization. Rapid technological advancements, particularly in information and communication technology (ICT), have reduced communication barriers and facilitated global connectivity. For example, the internet and digital platforms enable businesses to communicate, collaborate, and conduct transactions across borders in real-time.

- **Trade agreements:**

An organization like the world Trade organization (WTO) has encouraged free trade through the reduction of tariffs. Trade liberalization policies, such as the reduction of tariffs, removal of trade barriers, and participation in free trade agreements, have promoted international trade and investment. For instance, the establishment of the World Trade Organization (WTO) and regional trade blocs like the European Union (EU) have facilitated cross-border trade and investment flows.

- **Market Expansion:**

Globalization enables businesses to access new markets and customer segments worldwide. For instance, e-commerce platforms and digital marketplaces provide businesses with opportunities to reach consumers in different countries and regions, expanding their customer base and revenue streams.

- **Resource and Markets:**

The resource like minerals, Coal, oil, gas, human capital, have made a substantial contribution to globalization. increase in resource volatility increases globalization.

- **Global economic Trends**:

Economic trends such as economic growth, urbanization and changes in Consumer preferences can create opportunities for businesses promoting them to expand internationally.

- **Cost Efficiency:**

Access to cheaper labor, resources and production facilities in other countries can lower cost of businesses, promoting them to expand globally.

- **Political:**

The political issues of country make globalisation channelized as per political bosses. The regional trade understandings or agreements determine the scope of globalization.

- **Competition:**

More and more fierce competition has forced businesses to seek opportunities in the world market to compete successfully, businesses today must develop a global strategy.

Globalization of businesses has make global competition by enabling companies from different countries to compete in the same markets. For example, multinational corporations like Coca-Cola and McDonald's compete with local businesses worldwide, driving innovation and efficiency to gain market share

- **Changing Consumer Preferences:**

Globalization has led to convergence in consumer preferences, tastes, and lifestyles across borders. For example, global brands and cultural influences shape consumer behaviour and consumption patterns worldwide, creating demand for standardized products and services.

- **Advancements in transportation:**

Advancements in transportation, such as Logistics and air travel, have accelerated the globalization of businesses by reducing transportation costs and increasing the speed and efficiency of moving goods and people across borders. For example, containerization allows companies to ship products more efficiently and cost-effectively, while air travel enables executives to conduct business meetings and transactions worldwide in a matter of hours

5.0 International Business Environment

The international environment is going through a historic transformation. We are moving away from a world in which national economies were relatively isolated from each other by different barriers, towards a world in which national economies, are merging into an interdependent global economic system. The emerging global economy creates opportunities as well as presents challenges and threats to the business.

Micro and Macro Environment

- Micro environment can be defined as the forces in the firm’s immediate environment which directly influence the firm’s decisions and operations. These include suppliers, various market intermediaries and service organizations such as middlemen, transporters, advertising and marketing research agencies, competitors, customers and general public.
- Macro environment consists of broader forces which affect the firm as well as the other forces in the firm’s micro environment. These include factors such as political, legal, economic, social etc. Firms need to continuously monitor changes in these environmental forces and devise strategies to cope with them.

Domestic Foreign and Global Environment

- This classification is based on the location at which environmental forces exist and operate.
- Domestic environment consists of factors such as competitive structure, economic climate, political and legal factors which are essentially uncontrollable by a firm. These factors operate at the national level and the firms are generally familiar with them.

- Foreign environment consists of factors like social, political, economic, legal and cultural prevailing in a foreign country. The firm can neglect them only at the cost of losing business in the foreign markets

- Global environment transcends national boundaries and is not confined in its impact to just one country. Global environment exerts influence over domestic as well as foreign countries. It comprises of forces like world economic conditions, international financial systems, international agreements and treaties and regional economic groupings.

Components of International Business Environment

- Political environment
- Legal environment
- Economic environment
- Socio-cultural environment
- Technological environment
- Natural environment
- Demographic environment

5.1 Concept of Political Environment

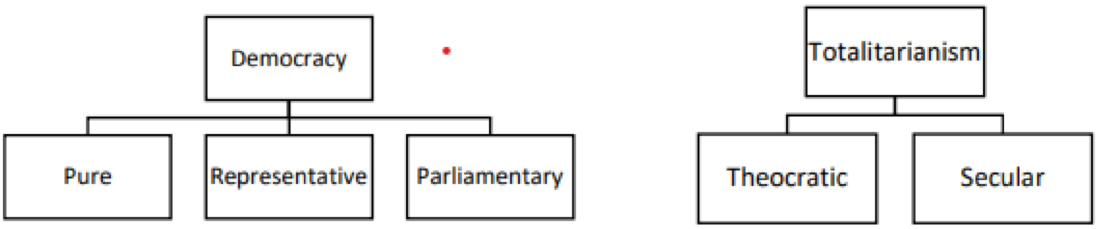
The political scenario in a country is the outcome of the interacting influence of various interest groups such as individual households, firms, politicians, bureaucrats, and many others. In other words, the political environment in international business consists of a set of political factors and government activities in a foreign market that can either facilitate or hinder a business' ability to conduct business activities in the foreign market.

- At the basis of international law and international relations: sovereignty (self-determination and independence from external interference, authority over all nationals)

- International trade limits sovereignty.

- Governments can invoke sovereignty and jeopardize firm's operations

Democracy vs. Totalitarianism: Two Sides of the Coin

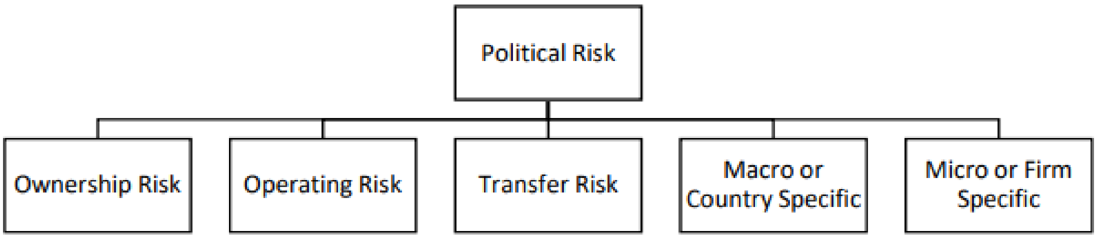


- **Democracy:** Involves citizen participation, either directly or indirectly, in shaping a country's policies.
  - **Pure Democracy:** Citizens directly make political decisions. (Rare in modern times)
  - **Representative Democracy:** Elected officials voice the will of the people. (Most common)
    - **Parliamentary Democracy:** Power lies with various interest groups influencing policy.
    - **Presidential Democracy:** Power resides more centrally with the President and their administration.

- **Totalitarianism:** Power rests in the hands of a select few, with little to no opposition.
    - **Theocratic Government:** Religion dictates political philosophy (e.g., Iran)
    - **Secular Totalitarianism:** Leaders rely on military or bureaucratic control (e.g., Communist regimes)

Political risk

Political risk is unanticipated changes in political set up in the host country leading to unexpected discontinuities that bring about changes in the very business environment. Classification of political risk:



- **Leftist vs Rightist Governments (Macro Risk):** A country's political ideology can significantly impact foreign businesses. Leftist governments may be more likely to impose regulations or restrictions, while rightist governments may favor deregulation. This creates a **Macro Risk** because it affects all businesses operating in that country.
- **Ownership Risk, Operating Risk, Transfer Risk (Micro Risk):** These political risks are specific to a firm's operations in a particular country.
    - **Ownership Risk (Micro Risk):** Risk of government seizing a foreign company's assets (e.g., expropriation).
    - **Operating Risk (Micro Risk):** Risk of government actions disrupting daily operations (e.g., changes in regulations).
    - **Transfer Risk (Micro Risk):** Risk of difficulty repatriating profits due to currency restrictions.

Macro political risk refers to risk affecting all foreign firms in a country emerges in account of expropriation, confiscation, creeping expropriation, nationalization, domestication, currency inconvertibility, credit risk, Ethnic, religious, or civil strife etc.

- Expropriation: involves payment of compensation for seizure of private property by government.
- Creeping expropriation: involves delayed payment of compensation but through heavy paperwork and judicial process.
- Confiscation: refers to seizure of private property by government without any payment of compensation.
- Nationalization: Local government taking over business or firm.
- Domestication: Transfer of business to local enterprises
- Currency inconvertibility: Host government enacts law prohibiting foreign companies from taking money out of the country.
- Credit risk: refusal to honor a financial contract with a foreign company.
- Ethnic, religious, or civil strife: Includes war and violence and racial, ethnic, religious, or civil strife within a country.

Micro political risk refers to risk affecting a particular industry or firm emerges on account of conflict between the bonafide objective of the host government and the operation of the MNC or on account of corruption.

- Conflicts of interest: The interest of MNCs is normally different from the interest of the host government. MNCs manifest in the maximization of corporate wealth, while host government is evident in the welfare of the economy.
- Corruption: It is endemic in many host countries, because of which MNCs must face serious problems.

Some other risk includes:

- Risk related to government trade polices
- Tariffs
- Exchange rate control
- Quotas: Quantitative restrictions
- Export/Import license requirement
- Embargo: Complete prohibition of trade
- Sanctions: Prohibition of trade for a specific period/term.
  - Rightist vs Leftist

By understanding the political environment and implementing these strategies, international businesses can navigate the complexities of the global marketplace and achieve sustainable success.

Minimizing of political risk

- Understand both ruling and opposition parties
- Remain politically neutral
- Be exemplary corporate citizens
- Use local supplies
- Partner with local companies and create local expertise
- Sell a quality product or service that is essential for local development
- Obtain insurance coverage against expropriation, nationalization, confiscation, and terrorism
  - Risk related to terrorism

5.2 Economic Environment

The global factors that are outside of the control of individual organizations but can affect the way that the businesses operate. Apart from the political and legal environment, the economic environment also influences international business decisions. This is because the decision to trade or to locate manufacturing operations varies from one host country to the other, depending on the form of the economic system existing there and on the various economic parameters prevailing there, for example level of income and inflation, health of industrial, financial and external sectors, fiscal and monetary policies; and many others. The present chapter discusses these issues at some length.

Forms of economic system

- Centrally planned economy: This is an economy where production and distribution system is owned by govt
- Market based economy: Where the market forces of demand and supply.
- Mixed economy system: Pvt and public sector co exist. Special economy zone

Economic Environment is classified into: -

- Income-Wise classification of countries

- ❖ Countries classified by economic system
- ❖ Classification of countries by region
- ❖ Economic scenario
- ❖ Financial system
- ❖ Economic policies
- ❖ Growth strategy

Income-wise classification of countries:

Several international agencies including the Organisation for Economic Cooperation and Development (OECD) and the United Nations classify countries by their economic status. But the best known system of classification is the one recommended by the World Bank in which 211 economies with a population of at least 30,000 are ranked by their levels of gross national income (GNI) per capita. These economies are then classified as low-income (LIC), lower-middle income (LMC), upper-middle income (UMC), high-income OECD, and other high-income countries.

- **Developing Countries: -**

Most developing countries share a set of common and well-defined goals. These include a reduction in poverty, inequality, and unemployment, the provision of minimum levels of education, health, housing, and food to every citizen; the broadening of economic and social opportunities; and the forging of a cohesive nation-state.

- **Developed Countries: -**

Those countries that are highly industrialised, highly efficient, and whose people enjoy a high quality of life are the developed countries. People in these countries usually receive excellent healthcare and benefit from the best educational systems in the world. Most developed nations also support programmes for helping poorer nations improve their economies and standards of living.

Countries Classified by Economic System

Another way of classifying countries is by their economic system. Keeping this in view, countries are classified as market economies, command economies, and mixed economies. The system of economy a nation follows In market economies do find their place. In contrast, in countries where collective goals are given prominence, state interventions and restricted markets do exist.

- **Market Economy**

In a market economy, also called capitalism, all productive functions are privately owned. Production of goods and services is not planned by individuals. Rather production is determined by the interaction of supply and demand forces. Whether to produce more or less depends on the price factor. If demand for a product exceeds its supply, price tends to rise prompting producers to produce more. If supply exceeds demand, prices will fall, signalling producers to produce less. In a market economy consumers are sovereign. Consumers decide what the producers should produce and supply.

- **Command Economy**

Also called socialism, in a command economy planning is a must. Decisions relating to all economic activities what to produce, how to price-are determined by added by the command economy the tools of production are organised, managed, and owned by the government, in a pure government, with the benefits accruing to the public. Consistent with collective ideology, the objective of a command economy is for government to own and run business for the good of society.

- **Mixed Economy**

- ➢ This falls midway between a market economy and a command economy.

- The economy set-up under this philosophy is split into three parts:
- Sectors in which both production and distribution are entirely managed and controlled by the state to the complete exclusion of private enterprise.
- Sectors in which the state and private enterprise jointly participate in production as well as in distribution.
- Sectors in which the private enterprise has complete access subject only to the general control and regulation of the state.

Classification of Countries by Region

A final way of classifying countries is by the region to which a nation belongs. The major regions are: -

- Pacific
- Europe (East and Central Europe)
- Asia(East and Central Asia)
- Latin America and the Caribbean
- Middle East and North Africa
- South Asia
- Sub-Saharan Africa

Factors influencing Economic environment

Per capita income and size of population: Per capita income is the average income earned by a person in a particular area over a period. It is often used as an indicator of a country's standard of living. A larger population size can indicate a larger market size, but it can also place a greater strain on resources.

Stages of economic development: Economies can be broadly categorized into four stages of development: pre-industrial, industrial, developing, and developed. Pre-industrial economies are largely agrarian. Industrial economies are characterized by a shift from agriculture to manufacturing. Developing economies are in the process of transitioning from agricultural to industrial economies. Developed economies have a well-developed industrial base and a high service sector. Understanding the stage of economic development of a country can help you understand the types of products and services that are in demand there.

Consumption pattern: Consumption patterns refer to the way people in a particular area use their income. This can be influenced by factors such as income level, age, culture, and climate. For example, people in wealthier countries tend to spend a larger proportion of their income on discretionary items such as entertainment and travel, while people in poorer countries spend a larger proportion of their income on basic necessities like food and shelter. Understanding consumption patterns can help businesses identify potential markets for their products or services.

Economic system: An economic system is the system that a country uses to produce and distribute goods and services. There are three main types of economic systems: market economies, command economies, and mixed economies. Market economies are characterized by private ownership of businesses and the use of prices to allocate resources. Command economies are characterized by state ownership of businesses and central planning. Mixed economies are a combination of market and command economies. The economic system of a country can affect the types of businesses that are allowed to operate there and the level of government regulation.

Product demand analysis: Product demand analysis is the process of estimating the demand for a particular product or service. This can be done by looking at factors such as population size, income levels, consumer preferences, and the availability of substitutes. Product demand analysis can help businesses decide whether or not to enter a new market, how to price their products, and how to market their products.

Competition analysis: Competition analysis is the process of identifying and evaluating a company's competitors. This can include looking at the competitors' products or services, their pricing strategies, their marketing strategies, and their strengths and weaknesses. Competition analysis can help businesses develop strategies to compete more effectively.

5.3 Cultural and Legal Environment Of International Business

The cultural and legal environment of international business encompasses a wide range of factors that influence how businesses operate across borders. Understanding and navigating these differences is crucial for successful global business operations. Cultural factors influence communication styles, decision-making processes, and business practices, while legal factors involve compliance with local laws regulations and trade agreements. Companies often adapt their strategies to fit into the cultural and legal contexts of the countries they operate in to foster positive relationships and ensure legal compliance.

5.3.1 Cultural Environment:

Culture represents the entire set of social norms and responses that dominate the behaviour of persons living in a particular geographic or political boundary. It is a fact that cultural boundaries may differ from national/ political boundaries because individuals with varying cultural backgrounds may reside in a particular nation. For example, Canada has at least three cultures—an Anglo culture, a French-speaking "Quebecois" culture and a Native American culture. It shows variation of the population and the communities that they follow which also act as a determinant in the operation of the business. Culture represents the whole set of social norms and responses that shape the knowledge, belief, morals, attitude, behaviour, and the very way of life of a person or a group of persons. Culture is not in-born. It is acquired and inculcated. It enables persons to communicate with others and to distinguish between what should be done and what should not be done.

What is Culture?

Culture is a way of life of a group of people- the behaviors, beliefs, values and symbols that they accept, generally without thinking about them, and that are passed along by communication and imitation from one generation to the next. Culture is defined as a continuously changing totality of learned and shared meanings, rituals, norms, and traditions among the members of an organization or society. Culture is also defined as a society's personality.

Culture has a general influence on consumption, has an influence on the stakeholders, determines the manner in which individuals respond to marketing strategies.

Elements of culture:

- **Language**: Language is the medium through which message is conveyed. Therefore it is a crucial element that represents the host country. One can get acquainted with the principal language but not with the dialects and the original meaning behind it hence making it type of factor that need to be taken care of. For example: The Pepsi Cola slogan, 'Come alive with Pepsi' was translated into German as 'come out of the grave'.
- **Religion:** Religion is another element of culture. Irrespective of forms, religion believes in a higher power. It sets the ideals of life and thereby the values and attitude of individuals living in a society. These values manifest in individuals' behaviour and performance. This affects the entrepreneurship and profit making.
- **Education**: The level of education in a particular culture depends primarily on the literacy rate and on enrolment in schools and colleges. This element has a close relationship with the availability of skilled manpower, availability of workers and managers who can be sent to the home country for training, production of sophisticated products, and with the adaptation of imported technology. This shows the availability of human as resource and how it could affect the business.
- **Attitude and Values**: Values are the belief and norms prevalent in a particular society. The attitude towards social status is an important factor. Those who believe in higher social status spend even more; and to this end, they work more and earn more. For example, in Japan, youth pay a higher price for Levi's jeans because such jeans give them higher social status. It is the status that

motivates individuals to opt for a particular branch of study. In less developed countries, bureaucracy is believed to the best profession which can affect the amount of resources that are available for setting up the business.

Diverse Culture and Competitive Advantage:

If an MNC moves to a country with a similar cultural environment, operational problems do not emerge on this count. But this is seldom a case. Generally, the culture in the parent company's country is found to be different from that in the country where its subsidiaries exist. This causes serious operational problems and effects the competitive advantage of the firm, which lies at the very root of every MNCs' success.

Some of the operational problems are:

- Problem of communication
- Acceptance of the innovated product
- Economies of scale
- Human resource management.
- Advertisement due to the aesthetic and religious sentiments of certain host countries.

Overcoming challenges :

There are various ways to overcome such challenges and sustain in the new country gaining success such as:

1. Cultural assessment: This would help gain insight before the entering to a new country which would help to a new profitable venture.
2. Adaptations to local culture: This helps to understand the market better and gain more access to the population of the market.
3. Transfusion of home country culture: It helps gain better understanding and gives an advantage to operating business.

Hofstede's study on cultural diversity

Hofstede's cultural dimensions theory is a framework used to understand the differences in culture across countries and the ways that business is done across different cultures. In other words, the framework is used to distinguish between different national cultures, the dimensions of c power culture, their impact on etiquette and to facilitate communication in areas ranging from business to diplomacy.

Hofstede's cultural dimensions theory was created in 1980 by Dutch management researcher Geert Hofstede who carried out an extensive survey during the 1960s and 1970s, investigating variations in values within different sectors of IBM, a global computer manufacturing company. The study comprised over 100000 employees from 50 countries across three regions.

Hofstede identified four major categories that define culture:

1. Power Distance

2. Collectivism vs. Individualism

3. Uncertainty Avoidance

4. Femininity vs. Masculinity

1. Power Distance

The power distance index considers the extent to which inequality and power are tolerated.

- A high power distance index indicates that a culture accepts inequity and power differences, encourages bureaucracy, and shows high respect for rank and authority.

- A low power distance index indicates that a culture encourages flat organization structures that feature decentralized decision making responsibility, a participative management style, and emphasis on power distribution.

For example, in countries with high power distance , parents may expect children to obey without questioning their authority. Conversely in countries with low power distance there tends to be more equality between parents and children, with parents more likely to accept children challenging their authority.

2. Individualism vs. Collectivism

The individualism vs. Collectivism dimension considers the degree to which societies are integrated into groups and their perceived obligations and dependence on groups.

- In Individualistic societies, the emphasis lies on personal achievement and rights, prioritizing the needs of oneself and ones immediate family.
- Collectivism indicates that there is a greater importance placed on the goals and well being of the group. A person's self image in this category is defined as “we” and individualism from collectivist backgrounds often prioritize relationships and loyalty more prominently than those in individualistic cultures.

3. Uncertainty Avoidance

This dimension considers how unknown situations, uncertainty and unexpected events are dealt with .

- A high uncertainty avoidance index indicates a low tolerance for uncertainty, ambiguity and risk taking, the unknown is minimized through strict rules, regulations, etc. Both the institutions and the individuals in these societies strive to reduce uncertainty by employing vigorous rules, regulations and similar measures.
- A low uncertainty index indicates a high tolerance for uncertainty and ambiguity. The unknown is more openly accepted, and there are lax rules, regulations, etc. Individuals and cultures with low uncertainty avoidance embrace and feel at ease in situations lacking structure or in fluctuating environments.

4. Masculinity vs. Femininity

The masculinity vs. femininity dimension is often referred to as gender role differentiation and examines the extent to which a society values traditional masculine and feminine roles.

- Masculinity includes the following characteristics: distinct gender roles, an appreciation of assertiveness, courage, strength and competition.
- Femininity includes characteristics such as fluid gender roles, modest, nurturing and concerned with the quality of life.

A high femininity score suggests that traditional feminine gender roles hold significant value within that society. For example, a country with high rating would probably offer improved maternity benefits and more accessible childcare services.

On the other hand, a country with a lower femininity score is likely to highlight increased female representation in leadership roles and a high prevalence of female entrepreneurship.

5.3.2 Legal Environment of International Business

A country’s legal system, which embraces its law and regulations, is closely related to its political system. For example, in a totalitarian political set up, the laws favour state ownership of industries. In a free political set up, on the other hand, laws tend to encourage private initiatives. The strategy of a firm will be different in a country with no restrictive regulations as compared to that in a country with too many restrictive regulations.

International legal environment get affected by international laws, host country laws and home country laws.

On the global level, there are broadly three types of legal systems:

i. Common law: Common Law is a law based largely on interpretation, tradition.

ii. Code (civil law): Civil Law is a system of law where rules and regulations are written in detail.

iii. Theocratic view/ systems: Theocratic Law is a law based primarily on religious preaching.

Principles of International Business Law

The international business law embraces the law of different countries as well as the bilateral and multilateral treaties and conventions. The principles governing international business law are as follows:

1. Rules of sovereignty and sovereign immunity: Sovereignty of state means that every state has complete freedom and power to govern.

2. Rules related to international jurisdiction.

3. Doctrine of comity: The doctrine of comity states that each country should have respect for the other country's law.

4. Rules related to aliens: A government can refuse to admit foreign citizens and can limit the area for their conduct. The government has the right to deport them. Thus, equality between a domestic citizen and a foreign citizen cannot be presumed under the international law.

Sometimes legal issues of global importance are dealt with differently in different countries, and they have an adverse impact on international business. This is why some international or the regional agencies are trying to bring about standardisation or uniformity with regard to such issues in respect of them. The WTO has made a move in this regard. The European Union too has brought about standardisation INTERNATIONAL BUSINESS MANAGEMENT of some of the legal issues among member countries. One of the important of the legal issue is intellectual property rights.

Intellectual property rights:

Intellectual property that embraces industrial property and copyrights, is protected through patents and trademark. A patent is a sort of protection granted to the inventor of the product or the process that does not allow others to make use of such inventions. Trademark is a symbol that differentiates a product from similar products. So long as the symbol is there, the product continues to remain differentiated. Similarly, copyrights are related to published material and they protect the publication from being copied.

This avoids counterfeit that is pirated version of the original product by violating its copyrights or trademark.

Hence both of these environment act as a determinant and proves to be crucial for the regulating and operating business internationally.

6.0 Ethical issues in international business and ethical decision making

It would be relevant to mention some ethical issues that have been the subject of debate among international managers in recent years. They are, for example, human rights, safety and environmental issues, corruption, and so on, which need some explanation here.

1) Ethics and Human Rights:

- It is often debated whether an international firm should move to a country, say, China where human rights are found violated.

- One view is that trade with and investment in such countries hardly deter human rights abuses as has been experienced in the case of Western trade and investment relations with China.
- On the contrary, the dismantling of apartheid in South Africa was possible through economic sanctions by some Western countries.
- The other view is that economic prosperity and political freedom go side by side.
- If foreign trade and investment bring about improvement in the living standards, human rights abuses would be contained.
- It is said that this was the philosophy behind President Clinton's decision to decouple human rights issues from foreign trade policy formulation.

2) Safety and Environmental Issues:

- Multinational corporations often face ethical dilemmas when operating in host countries with less stringent safety, pollution, or labor standards.
- While adhering to local norms may lower production costs, it can conflict with the company's ethical principles, such as avoiding child labor or maintaining strict safety protocols.
- Here we may quote the views of Richard T De George (1993) that in such cases the company should adopt consistency.
- This does not mean that the company should act consistently everywhere its subsidiaries exist.
- It should abide by the local customs so long as it is tolerable by its own standards.
- If it is beyond tolerance, the company should stick to its ethical norms.

3) Issue of Corruption:

- Bribery is considered unethical in many Western countries, where laws like the U.S. Foreign Corrupt Practices Act (FCPA) and OECD regulations strictly prohibit such practices.
- These laws prevent companies from offering bribes to foreign officials and don't allow tax deductions for overseas bribery.
- Although some argue that illegal payments can expedite approvals and reduce waiting times, these practices can be detrimental to economic growth by fostering unproductive corruption among bureaucrats and politicians (Mauro, 1995).
- Bribery undermines economic integrity and can harm long-term growth prospects.
- In contrast, cultural practices vary globally.
- For instance, in China, reciprocal gift-giving is common and may not be seen as unethical.
- International managers must navigate these cultural differences, balancing local customs against universal ethical standards to avoid engaging in corrupt practices.
- Ultimately, multinational corporations must prioritize ethical consistency, recognizing the fine line between respecting local traditions and upholding global ethical principles.

4) Issue of Consumerism:

- In developed countries, consumer protection is robust, but in many developing countries, these safeguards are weaker.
- This discrepancy allows multinational companies to sell harmful products that are banned in their home countries.

- For example, some medicinal products and tobacco are marketed with fewer restrictions in emerging economies, and human trials are sometimes conducted on uneducated populations without proper oversight.
- These practices can lead to significant harm and exploitation. Multinational companies have a responsibility to apply the same ethical standards and consumer protections wherever they operate, ensuring that their products and practices meet the safety norms of their home countries.
- Upholding social responsibility in all markets is crucial to prevent exploitation and promote global ethical standards.

5) Issue of Transfer Pricing:

- Transfer pricing is a means to encourage the illegal transfer of funds among the different units of a company through over-invoicing/under-invoicing of exports and imports.
- In many countries, there are strict rules restricting transfer pricing. Customs authorities are vigilant to check such practices.
- It is a fact that such practices lower the tax burden of the firm as a whole and smoothen the firm's international cash management, but it is unethical as it brings about loss to the exchequer in both the home country and the host country.

ETHICAL DECISION-MAKING IN INTERNATIONAL BUSINESS

1) Hire and promote people with a well-grounded sense of personal ethics

- Refrain from promoting individuals who have acted unethically
- Try to hire only people with strong ethics
- Prospective employees should find out as much as they can about the ethical climate in an organization prior to taking a position

2) Build an organizational culture that places a high value on ethical behavior

- Articulate values that place a strong emphasis on ethical behavior
- Emphasize the importance of a code of ethics - formal statement of the ethical priorities a business adheres to implement a system of incentives and rewards that recognize people who engage in ethical behavior

3) Make sure that leaders within the business articulate the rhetoric of ethical behavior and act in a manner that is consistent with that rhetoric

- Give life and meaning to words
- Make sure that leaders emphasize the importance of ethics verbally and through their actions

4) Put decision-making processes in place that require people to consider the ethical dimensions of business decisions

- Decisions fall within the accepted values of standards that typically apply in the organizational environment
- Decisions can be communicated to all stakeholders affected by it if colleagues would approve of decisions

7.0 GATT (General Agreement on Tariffs and Trade)

❖ The General Agreement on Tariffs and Trade (GATT) was a legal agreement signed on October 30, 1947, by 23 countries.

- Its main objective is to minimizing barriers in international trade by eliminating or reducing quotas, tariffs, and subsidies while preserving significant regulations.
- The GATT was intended to boost economic recovery after World War II through reconstructing and liberalizing global trade.
- The General Agreement on Tariffs and Trade (GATT) held eight rounds in total from April 1947 to December 1993, each with significant achievements and outcomes.
- In 1995, the General Agreement on Tariffs and Trade (GATT) was absorbed into the World Trade Organization (WTO), which extended it.
- One of the key achievements of the GATT was that of trade without discrimination. Every signatory member of the GATT was to be treated as equal to any other.
- This is known as the most-favoured-nation (MFN) principle, and it has carried through into the WTO.
- The average tariff rate fell from around 22%, when the GATT was first signed in Geneva in 1947, to around 5% by the end of the Uruguay Round, concluded in 1993, which also negotiated the creation of the WTO.
- In 1964 the GATT began to work toward curbing predatory pricing policies. These policies are known as dumping. As the years have passed, the countries have continued to attack global issues, including addressing agriculture disputes and working to protect intellectual property.

Different Rounds of GATT

There have been nine rounds of trade negotiations since the Second World War. The list Of WTO rounds (initially as GATT) is mentioned below:

1.Geneva Round (April 1947) – GATT was signed.

2.Annecy Round (April 1949) – Tariff Concessions discussed.

3.Torquay Round (September 1950) – Cut in tariff levels.

4.Geneva-II Round (January 1956) – Japan was admitted and tariff reductions.

5.Dillion round (September 1960) – Tariff Concessions.

6.Kennedy Round (May 1964) – Tariff Concessions and Anti-Dumping covered.

7.Tokyo Round (September 1973) – Tariff, Non-Tariff measures discussed.

8.Uruguay Round (September 1986) – WTO was created, tariffs and agricultural subsidies were reduced.

9.Doha Round (November 2001) – Multilateral environmental agreements, Trade barriers on environmental goods & services, Fisheries subsidies.

Uruguay Round of negotiations (1986)

The Uruguay Round was the 8th round of multilateral trade negotiations (MTN) conducted within the framework of the General Agreement on Tariffs and Trade (GATT), spanning from 1986 to 1993 and embracing 123 countries as “contracting parties”.

Features of Uruguay Round

- Reforms in safeguard measures and reforms in Agriculture.
- Reduction of Tariff to 3.9 percent from 40 percent.
- Removal or Abolishing the Non-tariff trade barrier.

- ❖ Constitution of TPRM (Trade policy review Mechanism) to examine the policy of member countries.
- ❖ Some new aspects of international trade are

  1.TRIMS- Trade related to investment measures.

  2.TRIPS- Trade related intellectual property rights.

  3.GATS- General agreement on trade in service. It is the milestone of this round.
- ❖ Establishment of Dispute settlement system (DSS). When any dispute arises between signing members then DSS settles it.
- ❖ GATT was conferred with the legal status for the first time by the creation of WTO.

Multi-lateral trade Agreement and Negotiation (MTN)

- ❖ A multilateral agreement is a trade agreement established between three or more countries with the intention of reducing barriers to trade, such as tariffs, subsidies, and embargoes, that limit a nation's ability to import or export goods.
- ❖ Multilateral agreements are usually negotiated between countries that share a geographic region, and some of the most well-known regional agreements are the North American Free Trade Agreement (NAFTA) and the Central American-Dominican Republic Free Trade Agreement (CAFTA).

Advantages of Multilateral Trade Agreements and Negotiation

- ❖ **Granting of "favoured nation status"** – No nation that is a party to a multilateral agreement can be granted more favourable trading rights than any other party to the agreement. Each country is treated as an equal partner.
- ❖ **Best use of a nation's resources** – Countries can focus on producing only those goods that are deemed valuable by its partners to the agreement, creating efficiencies in the allocation of resources.
- ❖ **Exported goods are cheaper** – Reduced tariffs mean that countries exporting their products no longer face artificial barriers to trade.
- ❖ **Standardization of regulations -** Companies can more easily navigate trade between signatory countries as a result of agreed upon rules of commerce.
- ❖ **One agreement versus many** – While multilateral agreements are often complex by their very nature, they actually, save countries the time and effort it takes to negotiate separate agreements with every potential trading partner.
- ❖ **Emerging markets flourish** – Bilateral agreements tend to favour the powerful. Multilateral agreements level the playing field for all participants, particularly the little guys who have been pushed around for years.

Disadvantages of Multilateral Agreement and Negotiation

- ❖ **Ceding of sovereign rights** – Countries that are partners in a multilateral agreement give up degrees of sovereignty over the way they conduct business with other countries, which often is in direct opposition to the democratic principles on which they were founded.
- ❖ **Some parties win, but some parties lose** – Certain industries within partner countries may be adversely affected by the low cost of imported goods by competing nations.
- ❖ **Complex and time-consuming negotiations**
- ❖ **Rise of multi-national corporation**

World Trade Organisation (WTO)

The World Trade Organization (WTO) is an international organization that deals with global rules of trade between nations. The main function of WTO is to ensure that trade flows as smoothly, predictably and freely as possible. It's an organization for liberalizing trade. It's a forum for governments to negotiate trade agreements. It's a place for them to settle trade disputes.

Headquarter: Geneva, Switzerland.

Membership: 164 countries

WTO Formation

The WTO began life on 1 January 1995, but its trading system is half a century older. Since 1948, the General Agreement on Tariffs and Trade (GATT) had provided the rules for the system. (The second WTO minister.) It did not take long for the General Agreement to give birth to an unofficial, de facto international organization, also known informally as GATT. Over the years GATT evolved through several rounds of negotiations. The last and largest GATT round, was the Uruguay Round which lasted from 1986 to 1994 and led to the WTO's creation. Whereas GATT had mainly dealt with trade in goods, the WTO and its agreements now cover trade in services, and in traded inventions, creations and designs (intellectual property).

Functions of the WTO

Broadly speaking, the function of the WTO is to implement, administer, direct, and further the

objectives of the multilateral and plurilateral trade agreements concluded during the Uruguay Round.

1. Provides a forum for further negotiations for trade liberalisation in the framework of the various

agreements concluded.

2. Administers the new dispute settlement procedure.

3. Establishes and directs a trade policy review mechanism so as to examine trade policies and

practices of the member countries and to suggest measures of reform.

4. Cooperates on an equal footing with the World Bank and the International Monetary Fund for the

purpose of economic policy making.

5. Undertakes research and publishes information and studies for the international community

Principles of the trading system at WTO

The WTO agreements are lengthy and complex because they are legal texts covering a wide range of activities. They deal with: agriculture, textiles and clothing, banking, telecommunications, government purchases, industrial standards and product safety, food sanitation regulations, intellectual property, and much more. But a number of simple, fundamental principles run throughout all of these documents.

These principles are the foundation of the multilateral trading system.

- **Trade without discrimination**

1. Most-favoured-nation (MFN):

Treating other people equally Under the WTO agreements, countries cannot normally discriminate between their trading partners. Grant someone a special favour (such as a lower customs duty rate for one of their products) and you have to do the same for all other WTO members. This principle is known as most-favoured-nation (MFN) treatment. It is so important that it is the first article of the General Agreement on Tariffs and Trade (GATT), which governs trade in goods. MFN is also a priority in the General Agreement on Trade in Services (GATS) (Article 2) and the Agreement on Trade-Related Aspects of Intellectual

Property Rights (TRIPS) (Article 4), although in each agreement the principle is handled slightly differently. Together, those three agreements cover all three main areas of trade handled by the WTO.

Some exceptions are allowed. For example, countries can set up a free trade agreement that applies only to goods traded within the group — discriminating against goods from outside. Or they can give developing countries special access to their markets. Or a country can raise barriers against products that are considered to be traded unfairly from specific countries. And in services, countries are allowed, in limited circumstances, to discriminate. But the agreements only permit these exceptions under strict conditions. In general, MFN means that every time a country lowers a trade barrier or opens up a market, it has to do so for the same goods or services from all its trading partners — whether rich or poor, weak or strong.

2. National treatment:

Treating foreigners and locals equally Imported and locally-produced goods should be treated equally — at least after the foreign goods have entered the market. The same should apply to foreign and domestic services, and to foreign and local trademarks, copyrights and patents. This principle of "national treatment" (giving others the same treatment as one's own nationals) is also found in all the three main WTO agreements (Article 3 of GATT, Article 17 of GATS and Article 3 of TRIPS), although once again the principle is handled slightly differently in each of these.National treatment only applies once a product, service or item of intellectual property has entered the market. Therefore, charging customs duty on an import is not a violation of national treatment even if locallyproduced products are not charged an equivalent tax.

Freer trade: gradually, through negotiation

Lowering trade barriers is one of the most obvious means of encouraging trade. The barriers concerned include customs duties (or tariffs) and measures such as import bans or quotas that restrict quantities selectively. From time-to-time other issues such as red tape and exchange rate policies have also been discussed.Since GATT's creation in 1947-48 there have been eight rounds of trade negotiations. A ninth round, under the Doha Development Agenda, is now underway. At first these focused on lowering tariffs (customs duties) on imported goods. As a result of the negotiations, by the mid-1990s industrial countries' tariff rates on industrial goods had fallen steadily to less than 4%.But by the 1980s, the negotiations had expanded to cover non-tariff barriers on goods, and to the new areas such as services and intellectual property.Opening markets can be beneficial, but it also requires adjustment. The WTO agreements allow countries to introduce changes gradually, through "progressive liberalization". Developing countries are usually given longer to fulfil their obligations.

Predictability: through binding and transparency

In the WTO, when countries agree to open their markets for goods or services, they "bind" their commitments. For goods, these bindings amount to ceilings on customs tariff rates. Sometimes countries tax imports at rates that are lower than the bound rates. Frequently this is the case in developing countries. In developed countries the rates actually charged and the bound rates tend to be the same.A country can change its bindings, but only after negotiating with its trading partners, which could mean compensating them for loss of trade. One of the achievements of the Uruguay Round of multilateral trade talks was to increase the amount of trade under binding commitments. In agriculture, 100% of products now have bound tariffs. The result of all this: a substantially higher degree of market security for traders and investors.

The system tries to improve predictability and stability in other ways as well. One way is to discourage the use of quotas and other measures used to set limits on quantities of imports — administering quotas can lead to more red-tape and accusations of unfair play. Another is to make countries' trade rules as clear and public ("transparent") as possible.Many WTO agreements require governments to disclose their policies and practices publicly within the country or by notifying the WTO. The regular surveillance of national trade policies through the Trade Policy Review Mechanism provides a further means of encouraging transparency both domestically and at the multilateral level.

Promoting fair competition

The WTO is sometimes described as a “free trade” institution, but that is not entirely accurate. The system does allow tariffs and, in limited circumstances, other forms of protection. More accurately, it is a system of rules dedicated to open, fair and undistorted competition.

The rules on non-discrimination — MFN and national treatment — are designed to secure fair conditions of trade. So too are those on dumping (exporting at below cost to gain market share) and subsidies. The issues are complex, and the rules try to establish what is fair or unfair, and how governments can respond, in particular by charging additional import duties calculated to compensate for damage caused by unfair trade.

Many of the other WTO agreements aim to support fair competition: in agriculture, intellectual property, services, for example. The agreement on government procurement (a “plurilateral” agreement because it is signed by only a few WTO members) extends competition rules to purchases by thousands of government entities in many countries. And so on.

Encouraging development and economic reform

The WTO system contributes to development. On the other hand, developing countries need flexibility in the time they take to implement the system’s agreements. And the agreements themselves inherit the earlier provisions of GATT that allow for special assistance and trade concessions for developing countries. Over three quarters of WTO members are developing countries and countries in transition to market economies. During the seven and a half years of the Uruguay Round, over 60 of these countries implemented trade liberalization programmes autonomously. At the same time, developing countries and transition economies were much more active and influential in the Uruguay Round negotiations than in any previous round, and they are even more so in the current Doha Development Agenda.

At the end of the Uruguay Round, developing countries were prepared to take on most of the obligations that are required of developed countries. But the agreements did give them transition periods to adjust to the more unfamiliar and, perhaps, difficult WTO provisions — particularly so for the poorest, “least-developed” countries. A ministerial decision adopted at the end of the round says better-off countries should accelerate implementing market access commitments on goods exported by the least-developed countries, and it seeks increased technical assistance for them. More recently, developed countries have started to allow duty-free and quota-free imports for almost all products from least-developed countries. On all of this, the WTO and its members are still going through a learning process. The current Doha Development Agenda includes developing countries’ concerns about the difficulties they face in implementing the Uruguay Round agreements.

ROLE OF INDIA IN WTO

On 1 January 1995, India became a part of WTO. As a WTO member, India is subjected to several significant agreements, including the Agreement on subsidies and Countervailing Measures, GATS, SPS, TRIPS, TRIMS, Agreement on Agriculture and the Agreement on Textiles.As of 2023, India is the seventh largest exporter of commercial services in the world, accounting for 4.6% of global trade in services industry experienced and acceleration in growth, buoyed by robust demand in the sector.

India plays a crucial role in the World Trade Organization (WTO) as one of its founding members and as one of the largest and most influential developing countries. India actively participates in WTO negotiations, advocating for the interests of developing nations, particularly in areas such as agriculture, intellectual property rights, and services. India's stance often reflects the concerns of developing countries regarding fair trade practices, market access, and special and differential treatment. Additionally, India engages in dispute settlement mechanisms to resolve trade disputes in accordance with WTO rules. Overall, India's role in the WTO is significant in shaping global trade policies and regulation. As far as quantitative restrictions are concerned, they are still maintained on the grounds of balance of payments inquiry. But, in May 1997 the Indian Government presented a detailed plan for the elimination of these restrictions in a phased manner over a period of 9 years. The length of the period was not acceptable to some of the importing countries. Therefore, it was reduced to six years, to which several countries, except the United States of America, have given their consent.

India has agreed to abide by the agreement on the intellectual property rights, ensuring nondiscrimination and transparency in this regard. In March 2005, the Indian parliament passed the patent bill in order to tune its provisions with those of the WTO. However, on the issue of public health, India still maintains that the Doha mandate should not be diluted to restrict the scope of defi nation of disease to just infection disease, as desired by the United States of America.

Under the trade related investment measures, India has already notified its stand. It has also assured establishment and administration of national standards and technical regulations in conformity with the MFN principle. However, there are many areas of special interest for India where it has tabled its conditional offer for liberal moves on the part of developed countries.

India has agreed to offer entry to foreign service providers in 33 lines of activities, which is more than the average for individual developing countries. In view of this very argument, India has made a couple of submission to the Negotiating Group of Rules: first, there should be special and differential treatment for developing countries during anti-dumping and countervailing duty investigation; second, there should be greater transparency in the rules related to regional trade agreements and fisheries subsidies; third, there should be more discussion on substantive issues under GATT Article XXIV.

The WTO made a third review of India's trade policy in June 2002. It was satisfied with the trade and FDI liberalisation policy of the country, although it was of the view that the tariff regime was still complex, containing numerous exemptions. It also raised concerns about large subsidies in the agricultural sector and about anti-dumping provisions.

INDIA'S PARTICIPATION

• GATT: 1948

• WTO: 1995

• Uruguay Round: 1986 - 1994

• Doha Round: 2001

• Bali Round: 2013

What is a Special Safeguard Mechanism?

- It is a mechanism used by countries to put a restraint on international trade to protect domestic industries from foreign competition.
- With a focus on WTO, a participating nation can take a safeguard action, such as restricting imports of a product temporarily to protect a domestic industry from an increase in imports causing or threatening to cause injury to domestic production.

Doha Round – Success or Failure

- The developed countries especially EU, the USA, Canada and Japan had differences with developing countries (India, Brazil, China, South Africa) arguments over Special Safeguard Mechanism (SSM)
- The negotiations considered in the Doha Round were taken up in Geneva in 2008 but were again stalled due to the lack of consensus on SSM.
- Issues over agricultural trade between the US, India and China led to the collapse of negotiations that started in Geneva in 2008.
- The SSM and Special Agricultural Safeguard (SSG) – SSG is mentioned in the Uruguay Round but many developing countries were unable to make its use as it is available for only those goods in which non-tariff barriers have been converted to equivalent tariff barriers

Module II

8.0 International Trade Theories

International trade theories are simply different theories to explain international trade. Trade is the concept of exchanging goods and services between two people or entities. International trade is then the concept of this exchange between people or entities in two different countries. While at the surface, this many sound very simple, there is a great deal of theory, policy, and business strategy that constitutes international trade.

- Classical country based theories
  - – Mercantilism
  - – Absolute advantage
  - – Comparative advantage
  - – Hecksher Ohlin

•Modern Firm based theories
- •Country similarity
- •Product Life cycle
- •Global strategic rivalry
- •Porter's national competitive advantage

<u>Theory of Mercantilism</u>:

Developed in the sixteenth century, mercantilism was one of the earliest efforts to develop an economic theory. This theory stated that a country's wealth was determined by the amount of its gold and silver holdings. Mercantilists believed that a country should increase its holdings of gold and silver by promoting exports and discouraging imports. In other words, if people in other countries buy more from you (exports) than they sell to you (imports), then they have to pay you the difference in gold and silver. The objective of each country was to have a trade surplus, or a situation where the value of exports are greater than the value of imports, and to avoid a trade deficit, or a situation where the value of imports is greater than the value of exports.

Nations expanded their wealth by using their colonies around the world in an effort to control more trade and amass more riches. The British colonial empire was one of the more successful examples, it sought to increase its wealth by using raw materials from places ranging from what are now the Americas and India. France, the Netherlands, Portugal, and Spain were also successful in building large colonial empires that generated extensive wealth for their governing nations.

- This theory was given by Thomas Mun and was Popular in the 16th and 18th Centuries.
- During that time, the Wealth of nations was measured by the stock of gold and other kinds of metals. The primary goal is to increase the wealth of the nation by acquiring gold.
- This theory says that a country should increase gold by promoting exports and discouraging imports.
- It is based on a zero-sum game. Zero-sum means only one nation gets benefits by exporting and the other gets a loss by importing goods.

Assumptions
1. There is a limited amount of wealth i.e. Gold in the world.
2. A nation can only grow when other nations do expenses or import goods.
3. A nation should try to achieve & maintain a favourable trade balance (exporting more than its import).

Advantage:

-Mercantilismcanhelptoincreaseacountry'swealthbyencouragingexportsanddiscouraging imports.
-Itcanhelptostimulatedomesticindustryandcreatejobsbyprotectingthemfromforeign competition.
-Itcanhelptopromoteself-sufficiencyandreduceacountry'srelianceonforeignsourcesof goods.

Disadvantages
1. Mercantilism theory only thinks about producing and exporting goods. This hardly paid attention to the welfare of workers which leads to the exploitation of workers.
2. Mercantilism was one-way traffic. It focuses on export but not import, it is not easy to be self-sufficient. Many countries of Europe fails to be self-sufficient which increased their miseries.

Absolute Advantage:

In 1776, Adam Smith questioned the leading mercantile theory of the time in his book "The Wealth of Nations". Smith offered a new trade theory called absolute advantage, which focused on the ability of a country to produce a good more efficiently than another nation. Smith reasoned that trade between countries shouldn't be regulated or restricted by government policy or intervention. He stated that trade should flow naturally according to market forces. In a hypothetical two-country world, if Country A could produce a good cheaper or faster (or both) than Country B, then Country A had the advantage and could focus on specializing on producing that good. Similarly, if Country B was better at producing another good, it could focus on specialization as well. By specialization, countries would generate efficiencies, because their labour force would become more skilled by doing the same tasks. Production would also become more efficient, because there would be an incentive to create faster and better production methods to increase the specialization. Smith's theory reasoned that with increased efficiencies, people in both countries would benefit and trade should be encouraged. His theory stated that a nation's wealth shouldn't be judged by how much gold and silver it had but rather by the living standards of its people.

a. This theory was given by Adam Smith in 1776. He argued for mercantilist theory & said that theory doesn't expand trade.

b. This trade theory is based on a positive-sum game and expansion of trade. A positive-sum game means both countries get benefits in trade. In this, both countries export absolute advantage goods to each other.

c. Absolute advantage means when a country can produce a product more effectively (less cost, more natural resources to produce easily) than other countries.

d) Both nations should export goods of production advantage and import goods of production disadvantage.

Disadvantage

1. This theory Fails to explain how free trade can be advantageous to two countries when one country can produce all goods.

2. Any nation not having an absolute advantage can't gain from free trade.

3. Differences in climatic conditions & natural resources in nations won't lead to absolute advantage.

Comparative Advantage:

The challenge to the absolute advantage theory was that some countries may be better at producing both goods and, therefore, they may have an advantage in many areas. The other country may not have any useful absolute advantages. David Ricardo, an English economist, introduced the theory of comparative advantage in 1817. Ricardo reasoned that even if Country A had the absolute advantage in the production of both products, specialization and trade could still occur between two countries. Comparative advantage occurs when a country cannot produce a product more efficiently than the other country. However, it can produce that product better and more efficiently than it does other goods. The difference between these two theories is subtle. Comparative advantage focuses on the relative productivity differences, whereas absolute advantage looks at the absolute productivity.

a) It is developed by David Ricardo in 1817.
b) This theory is the extension of the absolute advantage theory. i.e. If a country has an advantage in the production of two commodities, then compare the efficiency of both goods.
c) Produce and Export the good which can be produced more efficiently.

Example – India can produce both trucks and cars efficiently but for export, India needs to compare these goods with each other to find which goods have more efficiency. If car production has more efficiency then India should produce and export manufactured cars.

Disadvantages
1. This theory was based on only two countries & only two commodities, but international trade is among many countries with many commodities.
2. The Assumption of full employment helps theory to explain comparative advantage. The cost of production in terms of labour may change when the employment level increases or decreases.
3. Even if any country stopped production, nobody in the industry wants to lose their job.
4. Another disadvantage is that transportation costs are not considered in determining comparative cost differences.

Let's look at a simplified hypothetical example to illustrate the subtle difference between these principles. Miranda is a Wall Street lawyer who charges $500 per hour for her legal services. It turns out that Miranda can also type faster than the administrative assistants in her office, who are paid $40 per hour. Even though Miranda clearly has the absolute advantage in both skill sets, should she do both jobs? No. For every hour Miranda decides to type instead of do legal work, she would be giving up $460 in income. Her productivity and income will be highest if she specializes in the higher-paid legal services and hires the most qualified administrative assistant, who can type fast, although a little slower than Miranda. By having both Miranda and her assistant concentrate on their respective tasks, their overall productivity as a team is higher. This is comparative advantage. A person or a country will specialize in doing what they do relatively better. In reality, the world economy is more complex and consists of more than two countries and products. Barriers to trade may exist, and goods must be transported, stored, and distributed. However, this simplistic example demonstrates the basis of the comparative advantage theory.

Heckscher-Ohlin Theory (Factor Proportions Theory):

The theories of Smith and Ricardo didn't help countries determine which products would give a country an advantage. Both theories assumed that free and open markets would lead countries and producers to determine which goods they could produce more efficiently. In the early 1900s, two Swedish economists, Eli Heckscher and Bertil Ohlin, focused their attention on how a country could gain comparative advantage by producing products that utilized factors that were in abundance in the country. Their theory is based on a country's production factors—land, labour, and capital, which provide the funds for investment in plants and equipment. They determined that the cost of any factor or resource was a function of supply and demand. Factors that were in great supply relative to demand would be cheaper and factors in great demand relative to supply would be more expensive. Their theory, also called the factor proportions theory, stated that countries would produce and export goods that required resources or factors that were in great supply and, therefore, cheaper production factors. In contrast, countries would import goods that required resources that were in short supply, but higher demand. For example, China and India are home to cheap, large pools of labour. Hence these countries have become the optimal locations for labour-intensive industries like textiles and garments.

Factor Endowment Theory

a) Given by Eli Heckscher and Berlin Ohlin in 1993.

b) Also known as factor Proportion theory or Heckscher & Ohlin theory.
c) This theory is based on a country's available production factors i.e. land, labour, capital, etc. in the country.

d) It stated that countries would produce and export those goods which make intensive use of factors that are locally available in large quantities. In contrast, import those factors that are in short supply or locally scarce.

For example – India has large quantities of labour so India should export labour-intensive goods i.e. coal mining, large production, and import capital-intensive goods i.e. oil.

Disadvantages
1. Assumes that there is no unemployment

2. Gives more importance to supply and less importance to the demand of that commodity.

3. Ignores price differences, transport costs, economies of scale, external economies, etc.

Leontief paradox Theory

a) In this theory Findings were contradictory to predictions of Heckscher-Ohlin's theory and Given by Wassily Leontief in 1973.

b) He found out that the United States (US) – The most capital-abundant country in the world. Exported commodities that were more labour-intensive than capital-intensive.

c) Leontief concludes from this result that the US should adopt its competitive policy to match its economic realities.

Disadvantages
1. Leontief considered only capital & labour inputs, leaving out natural resource inputs But in reality, capital & natural resources are used together in the production of commodities.

Country Similarity Theory:

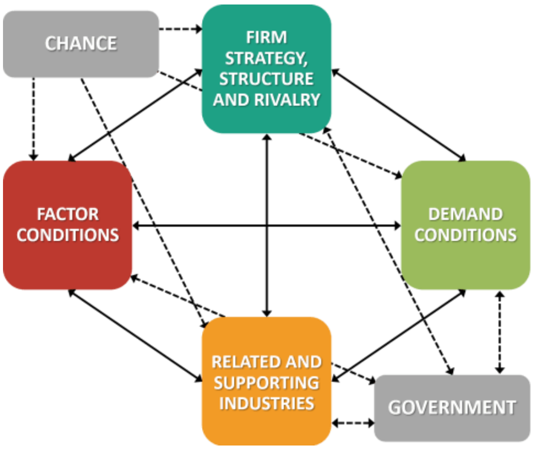
Swedish economist Steffan Linder developed the country similarity theory in 1961. Linder's theory proposed that consumers in countries that are in the same or similar stage of development would have similar preferences. In this firm-based theory, Linder suggested that companies first produce for domestic consumption. When they enter the exporting option, the companies often find that markets that look similar to their domestic one, in terms of customer preferences, offer the most potential for success. Linder's country similarity theory then states that most trade in manufactured goods will be between countries with similar per capita incomes, and in train industry trade will be common. This theory is often most useful in understanding trade in goods where brand names and product reputations are important factors in the buyers' decision-making and purchasing processes

Global strategic rivalry theory

Paul Krugman and Kelvin Lancaster were the founders of this theory. This theory emerged around the 1980s. The theory majorly focused on multinational companies and their strategies and efforts to gain a comparative advantage over other similar global firms in their industry. This theory acknowledges the fact that firms will face global competition and prove their superiority. They must surely develop a competitive advantage over each other. The ways through which the firms can gain competitive advantage were termed as barriers to entry for that particular industry. These barriers are basically the obstacles that a firm will face globally when they enter the market. The barriers that companies and firms may try to optimise are:

1. Mainly research and development,
2. The ownership of intellectual property rights,
3. Economies of scale,
4. Unique business processes or methods,
5. Extensive experience in the industry, and
6. The control of resources or favourable access to raw materials.

Porter's National Competitive Advantage Theory:



In the continuing evolution of international trade theories, Michael Porter developed a new model to explain national competitive advantage in 1990. His theory focused on explaining why some nations are more competitive in certain industries. To explain his theory, Porter identified four determinants that he linked together. The four determinants are :

Local market resources and capabilities (factor conditions). Porter recognized the value of the factor proportions theory, which considers a nation's resources (e.g., natural resources and available labour) as key factors in determining what products a country will import or export.

Local market demand conditions. Porter believed that a sophisticated home market is critical to ensuring ongoing innovation, thereby creating a sustainable competitive advantage. Companies whose domestic markets are sophisticated, trendsetting, and demanding forces continuous innovation and the development of new products and technologies.

Local suppliers and complementary industries. To remain competitive, large global firms benefit from having strong, efficient supporting and related industries to provide the inputs required by the industry. Certain industries cluster geographically, which provides efficiencies and productivity.

Local firm characteristics. Local firm characteristics include firm strategy, industry structure, and industry rivalry. Local strategy affects a firm's competitiveness. A healthy level of rivalry between local firms will spur innovation and competitiveness.

In addition to the four determinants of the diamond, Porter also noted that government and chance play a part in the national competitiveness of industries. Governments can, by their actions and policies, increase the competitiveness of firms and occasionally entire industries.

Disadvantages

1. In his book, Porter was optimistic about the future of Korea & less optimistic about the future of others.

2. Other factors may influence success – there may be events that could not have been predicted, such as new technological developments or government interventions.

Product life cycle theory:

This theory was propounded by Raymond Vernon, a business professor at Harvard Business School, in the 1960s. The theory that originated in the field of marketing proposed that a product life cycle has three stages, namely, new product, maturing product, and standardised product.

New Product Introduction, The cycle always begins with the introduction of a new product. In this stage a corporation in a developed country will innovate a new product. The market for this product will be small and sales will be relatively low as a result. Vernon deduced that innovative products are more likely to be created in a developed nation because the buoyant economy means that people have more disposable income to use on new products. As sales increase, corporations may start to export the product out to other developed nations to increase sales and revenue.

The Maturity Stage At this point, when the product has firmly established demand in developed countries, the manufacturer of the product will need to consider opening up production plants locally in each developed country to meet the demand. As the product is being produced locally, labour costs and export and costs will decrease thereby reducing the unit cost and increasing revenue.

Product Standardization and Streamlining of Manufacturing Exports to nations with a less developed economy begin. Rather than continuing to add new features to the product, the corporation focuses on driving down the cost of the process to manufacture the product. They do this by moving production to nations where the average income is much lower and standardizing and streamlining the manufacturing methods needed to make the product. Meanwhile, demand in the original nation where the product came from begins to decline and eventually dwindles as a new product grabs the attention of the people.

9.0 Theories of International Investment

What is a Foreign Direct Investment (FDI)?

- Foreign direct investment (FDI) is the acquisition of an interest or an ownership stake in a foreign firm or project by a foreign investor, corporation, or government.
- The controlling ownership of a commercial company in one country by an entity headquartered in another country is also referred to as a foreign direct investment (FDI), a subset of international factor movements.
- Once a firm undertakes FDI it becomes a multinational enterprise
- There are two forms of FDI-

- A greenfield investment (the establishment of a wholly new operation in a foreign country).
- A brownfield investment (acquisition or merging with an existing firm in the foreign country).

- Loans taken out in the host nation, payments made in return for equity (patents, technology, machines, etc.), and other strategies can all be used to fund foreign direct investment.
- The key factors affecting FDI are the country's economic development prospects at the time FDI is made. In response to concerns, Hymer included some more FDI variables while also assuming market inefficiencies. These are listed below:

    1. **Firm-specific Advantages**: After domestic investment is used, a company might use its advantages related to market flaws, which may provide the company with a competitive edge and market power. Additional research can make an effort to clarify how businesses may profit from these benefits by selling licenses.
    2. **Removal of Conflicts**: Conflict results when a company wants to extend its activities inside the same market or is already active in a foreign market. He suggested that this obstacle can be overcome by collusion, market-sharing with competitors, or seeking to take direct control of manufacturing. However, it must be remembered that increasing market flaws will result from a decrease in conflict via the gain of operational control.
    3. **Possibility of Developing an Internationalization plan to Reduce Risk**: He contended that three levels of decision-making distinguish businesses: day-to-day management, coordination of management decisions & long-term strategy development and decision-making. How well a corporation can develop an internationalization plan while considering these levels of choice will determine how much risk it can reduce.

Examples of Foreign Direct Investment

Mergers, acquisitions, or joint ventures in the retail, service, logistics, or manufacturing sectors may be part of foreign direct investments. They point to a global business expansion plan.

They may also encounter regulatory issues. For instance, the U.S. business Nvidia announced in 2020 that it would buy the British chip designer ARM, a U.K. chip designer. The U.K.'s competition authority stated in August 2021 that it would look into whether the $40 billion transaction would lessen competition in sectors that depend on semiconductor processors. However, the deal was called off later.

Advantages of Foreign Direct Investment (FDI)

1.Economic Growth:

The creation of jobs is the most evident advantage of FDI, and this is one of the big factors a nation (especially one emerging) will seek to attract FDI. FDI increases the manufacturing and service sectors, which leads to job growth and lower unemployment rates in the nation. Increased employment increases earnings and gives the populace greater purchasing power, strengthening a nation's economy.

2. **Human Capital Development:**

Human capital is a term that describes a worker's abilities and expertise. Employee training and experience-based skills may improve a nation's human capital and educational system. It has a cascading impact that trains human resources in various industries and businesses.

3. **Technology Advancements**

Targeted nations and organizations have access to the newest financial instruments, innovations, and management techniques from around the globe. The introduction of newer and improved technology leads to the diffusion of businesses into the local economy, resulting in increased industrial efficiency and effectiveness.

4. **Increase in Exports**

The markets for many FDI-produced commodities extend beyond local markets. Establishing solely export-oriented businesses helps FDI investors support increased exports from other nations.

5. Exchange Rate Stability

A country's central bank is assisted in maintaining a healthy foreign currency reserve, which leads to stable exchange rates through foreign direct investment.

6. Improved Capital Flow

The cash inflow is especially advantageous for governments with few internal resources and few chances to raise money in international capital markets.

7. Establishment of a Competitive Market

By permitting the entrance of foreign companies into the domestic market, FDI helps create a challenging market and the breakup of domestic firms. A robust competitive environment encourages innovation by pushing businesses to improve their operations and product lines. Additionally, customers can access a greater selection of items at affordable prices.

8. Climate

The UN has also encouraged the use of global FDI to help fight climate change.

Disadvantages of Foreign Direct Investment (FDI)

1. Domestic Investment Barriers

FDI may occasionally prevent domestic investment. Due to FDI, domestic enterprises in certain nations become less interested in purchasing their products.

2. The Risk from Political Changes

Foreign investment may suffer from frequent changes in other countries' political environments.

3. Negative Exchange Rates

Often, foreign direct investments influence the currency rate, helping one country while hurting another.

4. Higher Costs

Investors can see that investing abroad is more costly than exporting products. Equipment and confidential information are regularly purchased with more money than the wages of local employees.

5. Economic Non-Viability

Foreign direct investments can be exceedingly risky or economically unviable at times since they need a large amount of cash from the investor.

6. Expropriation

Political turbulence all the time might result in expropriation. In this situation, the governments of those nations will be in charge of the assets and property of the investors.

7. Economic Colonization in the Modern World

Many nations, or at least those with a history of colonialism, fear that foreign direct investment would lead to some form of contemporary economic colonialism, leaving host nations exposed and open to exploitation by international corporations.

8. Bad Performance

Multinational corporations have come under fire for unfavourable working conditions in overseas manufacturing.

Foreign Institutional Investor (FII):

This is the more common meaning in the context of the Indian stock market. FIIs are institutional investors from outside India who invest in Indian stocks and bonds. Their activity can significantly impact the Indian stock market.

For example, news articles might discuss FII activity and its effect on the market sentiment or specific sectors.

Theories of Foreign Direct Investment

1. **MacDougall-Kemp hypothesis**

- It's a two countries model – one being an investing country and the other is host country.
- Price of capital equal to marginal productivity.
- Capital moves freely from capital abundant country to capital scarce country and in this way marginal productivity of capital tends to equalize between two countries.
- So long as the income from foreign investment is greater than the loss of output, the investing country continues to invest abroad.
- The host country also witness increase in national income.

2. **Industrial organization theory**

- Based on oligopolistic and imperfect market conditions.
- Market imperfection arises because of product differentiation, marketing skills, proprietary technology, managerial skills, better access to capital, economies of scale etc.
- Stephen Hymer said MNCs are a typical oligopolistic firm that possess some sort of superiority to maximize profit.
- The firm specific advantage refers to technological advantages which help the firm to produce a new product different from existing one.

3. **Location specific theory**

- Hood and young argue that real wage cost varies among countries.
- Firm with low cost technology move to low wage countries.
- Some countries, trade barriers are created to restrict import.
- MNCs invest in those countries to start manufacturing and availing the benefit of cheap and abundant raw materials.
- Dabur moved to Nepal.

4. Product cycle theory

- Raymond Vernon feels that most product follows a three stages life cycle
- Innovation stage – firm innovates with the help of R &D. Price inelastic.
- Maturing product stage – Demand for the new product in other developed countries grow and become price elastic

- Standardised product stage – price competitiveness become more important. Innovator shifts the production to a low cost location, preferably a developing country where labour is cheap.
- Dematuring stage – sophisticated models are manufactured again in advanced technology.

The Eclectic Paradigm

John Dunning's eclectic paradigm argues that in addition to the various factors discussed earlier, two additional factors must be considered when explaining both the rationale for and the direction of foreign direct investment

- location-specific advantages (that arise from using resource endowments or assets that are tied to a particular location and that a firm finds valuable to combine with its own unique assets)
- externalities (knowledge spillovers that occur when companies in the same industry locate in the same area)

10.0 Regional Trade blocs in international trade

A regional trading bloc is a group of countries within a specific geographic region that protect themselves from imports from non-members. In general terms, regional trade blocks are associations of nations at a governmental level to promote trade within the block and defend its members against global competition.

Examples; -

- The European Union (EU) is a regional trade bloc that includes 27 European countries

and promotes economic integration and cooperation among its member states. The EU operates as a single market, with the free movement of goods, services, capital, and people within the region.

- The North American Free Trade Agreement (NAFTA) is a regional trade bloc that

includes Canada, the United States, and Mexico, and promotes trade and economic cooperation among its member countries

There are four types of trading blocs –

Preferential Trade Area: Preferential Trade Areas (PTAs), the first step towards making a full fledged RTB, exist when countries of a particular geographical region agree to decrease or eliminate tariffs on selected goods and services imported from other members of the area.

Free Trade Area: Free Trade Areas (FTAs) are like PTAs but in FTAs, the participating countries agree to remove or reduce barriers to trade on all goods coming from the participating members.

Customs Union: A customs union has no tariff barriers between members, plus they agree to a common (unified) external tariff against non-members. Effectively, the members are allowed to negotiate as a single bloc with third parties, including other trading blocs, or with the WTO.

Common Market: A 'common market' is an exclusive economic integration. The member countries trade freely all types of economic resources– not just tangible goods. All barriers to trade in goods, services, capital, and labour are removed in common markets. In addition to tariffs, non-tariff barriers are also diminished or removed in common markets.

Objectives of trade blocks

• Reduction of trade barriers among member countries

• Maintaining better relation

• Imposing barriers on non-member countries

• Promoting free transfer of labour, capita etc.

• Creating common currency and central bank

• Assisting member countries

• Enhancing consumer welfare

• Generating competition

• Promoting higher employment

Regional Trading Blocs Advantages

• Foreign Direct Investment − Foreign direct investment (FDI) surges in TRBs and it benefits the economies of participating nations.

• Economies of Scale − The larger markets created results in lower costs due to mass manufacturing of products locally. These markets form economies of scale.

• Competition − Trade blocs bring manufacturers from various economies, resulting in greater competition. The competition promotes efficiency within firms.

• Trade Effects − As tariffs are removed, the cost of imports goes down. Demand changes and consumers become the king.

• Market Efficiency − The increased consumption, the changes in demand, and a greater number of products result in an efficient market.

Regional Trading Blocs – Disadvantages

The disadvantages of having a Regional Trading Bloc are as follows –

• Regionalism − Trading blocs have bias in Favor of their member countries. These economies establish tariffs and quotas that protect intra-regional trade from outside forces. Rather than following the World Trade Organization, regional trade bloc countries participate in regionalism.

• Loss of Sovereignty − A trading bloc, particularly when it becomes a political union, leads to partial loss of sovereignty of the member nations.

• Concessions − The RTB countries want to let non-member firms gain domestic market access only after levying taxes. Countries that join a trading bloc needs to make some concessions.

• Interdependence − The countries of a bloc become interdependent on each other. A natural disaster, conflict, or revolution in one country may have adverse effect on the economies of all participants.

The South Asian Association for Regional Cooperation (SAARC)

Name: South Asian Association for Regional Cooperation

Acronym: SAARC

Year of foundation: 1985

Headquarters: Kathmandu, Nepal

The South Asian Association for Regional Co-operation (SAARC) is an organisation of South Asian nations, which was established on 8 December 1985 when the government of Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka formally adopted its charter providing for the promotion of economic and social progress, cultural development within the South Asia region and for friendship and co-operation with other developing countries. The Secretariat of the Association was set up in Kathmandu on 17 January 1987. It is dedicated to economic, technological, social, and cultural development emphasising collective self- reliance. In terms of population, its sphere of influence is the largest of any regional organisation. In April 2007, Afghanistan became its eighth member.

Objectives

The objectives of the Association as outlined in the SAARC Charter are:

• to promote the welfare of the peoples of South Asia and to improve their quality of life;

• to accelerate economic growth, social progress, and cultural development in the region

and to provide all individuals the opportunity to live in dignity and to realize their full

potentials;

• to promote and strengthen collective self-reliance among the countries of South Asia;

• to contribute to mutual trust, understanding and appreciation of one another's problems;

• to promote active collaboration and mutual assistance in the economic, social, cultural,

technical, and scientific fields;

• to strengthen cooperation with other developing countries;

• to strengthen cooperation among themselves in international forums on matters of

common interests; and

The Organization of the Petroleum Exporting Countries (OPEC)

Brief history and members: The Organization of the Petroleum Exporting Countries (OPEC) was founded in Baghdad, Iraq, with the signing of an agreement in September 1960 by five countries namely Islamic Republic of Iran, Iraq, Kuwait, Saudi Arabia and Venezuela. They were to become the Founder Members of the Organization.

These countries were later joined by Qatar (1961), Indonesia (1962), Libya (1962), the United Arab Emirates (1967), Algeria (1969), Nigeria (1971), Ecuador (1973), Gabon (1975), Angola (2007), Equatorial Guinea (2017) and Congo (2018). Ecuador suspended its membership in December 1992, rejoined OPEC in October 2007, but decided to withdraw its membership of OPEC effective 1 January 2020. Indonesia suspended its membership in January 2009, reactivated it again in January 2016, but decided to suspend its membership once more at the 171st Meeting of the OPEC Conference on 30 November 2016. Gabon terminated its membership in January 1995. However, it rejoined the Organization in July 2016. Qatar terminated its membership on 1 January 2019.

This means that, currently, the Organization has a total of 13 Member Countries.

The OPEC Statute distinguishes between the Founder Members and Full Members – those countries whose applications for membership have been accepted by the Conference. The Statute stipulates that “any country with a substantial net export of crude petroleum, which has fundamentally similar interests to those of Member Countries, may become a Full Member of the Organization, if accepted by a majority of three-fourths of Full Members, including the concurring votes of all Founder Members.

Goals of OPEC

- OPEC's first goal is to keep prices stable. It wants to make sure its members get a reasonable price for their oil. Since oil is a somewhat uniform commodity, most consumers base their buying decisions on nothing other than price.
- OPEC's second goal is to reduce oil price volatility. For maximum efficiency, oil extraction must run 24 hours a day, seven days a week. Closing facilities could physically damage oil installations and even the fields themselves. For example, in June 2008, oil prices hit an all-time high of $143 per barrel. OPEC responded by agreeing to produce a little more oil. This move brought prices down. But the global financial crisis sent oil prices plummeting to $33.73 per barrel in December. OPEC responded by reducing the supply. Its move helped prices to again stabilize.
- OPEC's third goal is to adjust the world's oil supply in response to shortages. For example, it replaced the oil lost during the Gulf Crisis in 1990. Several million barrels of oil per day were cut off when Saddam Hussein's armies destroyed refineries in Kuwait. OPEC also increased production in 2011 during the crisis in Libya.

The European Union (EU):

The European Union is a unified trade and monetary body of 27 member countries. It eliminates all border controls between members. The open border allows the free flow of goods and people, except for random spot checks for crime and drugs. Any product manufactured in one EU country can be sold to any other member without tariffs or duties. Practitioners of most services, such as law, medicine, tourism, banking, and insurance, can operate in all member countries. As a result, the cost of airfares, the internet, and phone calls are typically lower than in the United States. Member countries: As of 2018, the European Union has 28 members - all European countries. The countries comprising the European Union are Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom. However, in 2019, Britain is set to leave the European Union, bringing the total down to 27 countries.

Objectives:

- A common European area without borders: The objective is to create a free and safe Europe with no internal borders. The citizens living in the area enjoy the rights granted by the European Union.
- Internal market: The objective is to ensure smooth and efficient trade within Europe. Competition between companies is free and fair.
- Stable and sustainable development: The objective is to ensure Europe’s sustainable and steady development. It means balanced economic growth and stable prices.
- Scientific and technological development: The European Union supports the advancement of science and technology and invests in education.
- Prevention of social exclusion: The European Union works hard to prevent social exclusion. It seeks to prevent people from drifting outside the labour market and society.
- Solidarity (unity): Solidarity between countries and people is promoted in the field of the economy, social equality and regions. The member states must be loyal to one another.
- Respect for languages and cultures: The European Union respects the languages and cultures of the individual countries. National cultures and the common European culture are cherished and developed

- Common foreign and security policy: The European Union seeks to promote peace not only in Europe but also elsewhere in the world. It seeks to ensure that peace is maintained in Europe and that people have security. With the common foreign policy, the European Union wants to make sure that the resources of the planet are used sensibly and that the environment is not destroyed.

11.0 Instruments of Trade Policy and Trade Barriers

Trade barriers are restrictions imposed on the movement of goods between countries (import and export). The major purpose of trade barriers is to promote domestic goods than exported goods, and thereby safeguard the domestic industries. Trade barriers can be broadly divided into tariff barriers and non-tariff barriers.

On the basis of inward-looking policy or outward-looking policy a government applies number of tools as an instrument of trade regulation. This regulation can be tariff and non-tariff trade barrier.

- **Tariff Trade Barrier**

A tariff is a duty(tax) imposed on goods involved in international trade by the government.

There are different types of tariff trade barrier: -

a) **Specific tariff** – A fixed fee levied on per unit of an imported good is referred to as a specific tariff. For example, a country could levy a $15 tariff on each pair of shoes imported, but levy a $300 tariff on each computer imported.

b) **Ad Valorem Tariff -** When the tariff assessed on percentage of value of the imported good it is called as ad valorem tariff. For example a country imposing tariff of 15% on import of automobiles.

c) **Combined Tariff -** A combined tariff may also be levied and shall be calculated partly as a percentage on value and partly as a rate per unit or weight.

d) **Counter vailing duty-** When the government imposes tariff to negate the impact of unfair trade practices it is called as counter vailing duty.

e) **Effective rate of tariff –** Tariff on component or raw material.

f) **Nominal rate of tariff –** Tariff on finished goods.

g) **Anti-dumping duty:** At times exporters attempt to capture foreign markets by selling goods at rock-bottom prices, such practice is called dumping.

h) **Protective tariff:** In order to protect domestic industries from stiff competition of imported goods, protective tariff is levied on imports.

- **Non – Tariff Trade Barrier**

Non-tariff barriers to trade (NTBs) are trade barriers that restrict imports but are unlike the usual form of a tariff; And Tariff Barriers restrict exports. Some common examples of NTB's are anti-dumping measures and countervailing duties, which, although called non-tariff barriers.

Any measures, other than a tariff, used by countries to restrict international trade is known as non-tariff trade barrier.

a) **Quotas-** These refers to quantitative limits on the quantity of goods that may be imported into a country during a specific period.

b) **Voluntary Export Restraints –** The exporting country asked by the importing country to limit the supply of particular commodity is voluntary export restraints. The restriction imposed here is not by importing country but by the exporting country.

c) **Licenses –** A license system allows authorized companies to import specific commodities that are included in the list of licensed goods.

d) **Subsidies –** Subsidies are one type of non-tariff barrier which take many forms such as cash assistance by the government tax concession, loans at lower interest rate, in this way they allow domestic producer to produce goods at lower price than import competing goods.

There are two types of Subsidies: -

i. **Domestic Subsidies:** The domestic producer can be efficient in producing goods effectively than international manufacturer. Domestic subsidies are much better than tariff & quota because the consumers are not force to reduce their demand & there is no effect on consumption process.

ii. **Export Subsidies:** Export subsidies are confined to those producers that produce goods for export, in this case the price of domestic commodity is higher than the foreign price.

e) **Embargo –** An embargo is a complete ban on trade (import & export) in one or more products with a particular country.

Other NTBs are:

- Health and safety regulations.

- Technical formalities

- Environment regulations

12.0 Global Portfolio Management

Global Portfolio Management is spreading your investments across different countries to reduce risk and make more money. Purchasing of stocks, bonds and money market instruments by foreigners for the purpose of realizing a financial return which does not result in foreign management, ownership or control.

- Global Portfolio Investment means the purchase of stocks, bonds and money market instruments by foreigners for the purpose of realizing a financial return which does not result in foreign management, ownership or control.
- So Global Portfolio Management refers to grouping of investment assets from international or foreign markets rather than from domestic ones.
- An international portfolio is designed to give the investors exposure to growth in emerging and international markets and provide diversification.
- The most common examples are share purchase of a foreign company, buying bonds that are issued by a foreign government, acquiring assets in a foreign firm.

Factors affecting Global Portfolio investment :-

- **Tax rates on interest or dividends**

When you earn money from interest on savings or dividends from investments, a portion of that income goes to taxes. These tax rates can vary depending on where you live and the type of income you receive.

- **Interest rates**

It is like the price of borrowing money. When they're high, borrowing gets expensive, and saving gets more rewarding. Central banks use them to control how much people spend and invest, affecting everything from mortgages to the stock market.

- **Exchange rates**

It is like the price tag for converting one currency into another. It tells you how much one currency is worth in terms of another. So, if you're traveling or buying something from another country, you'll need to know the exchange rate to figure out how much it will cost you in your own currency.

Problems of Global Portfolio Investment :-

- **Unfavourable exchange rate movement**

It means your money is worth less when you exchange it for another currency. So, if your currency weakens compared to another, it makes things like imports, travel, and investments in other countries more expensive.

- **Frictions in international financial markets**

It means bumps or hurdles that make it harder to move money and do business across borders. These can include extra costs, not having enough information, or dealing with unpredictable changes in currency values and politics.

- **Manipulation of security prices**

It means people trying to cheat by artificially making stocks or other investments look more valuable than they really are. They might spread lies to trick others into buying or selling at the wrong prices.

- **Unequal access to information**

It means some investors have better knowledge about investments in different countries than others when making investment decisions across different countries.

This can affect the fairness and efficiency of international financial markets as well as the performance of global investment portfolio.

Different modes of Global Portfolio Management:-

The stock exchange of a foreign country directly offers the investors with their respective depository receipts of foreign securities.

There are two different modes of Global Portfolio Management are :-

1. Portfolio Equity
2. Portfolio Bonds

Portfolio Equity:-

It refers to investments in the form of stocks or shares of ownership in companies. When investors buy shares of a company's stock, they become partial owners of that company. Portfolio equity investments are typically made with the expectation of increase in the value of the shares and may also provide dividends, which are payments made by the company to its shareholders. These investments offer the potential for higher returns but also come with higher risk due to the volatility of stock markets.

Portfolio Bonds:-

Portfolio bonds are like a bundle of loans you give to governments or companies by buying their bonds. You get regular payments in return, like interest, and get your initial investment back when the bond matures.

The investments that are either long-term or medium-term are termed as bond. The following are the situations that are considered appropriate for investing in portfolio bonds are as follows -

- When there are additional funds to invest
- When there is either any one or a combination of income and growth potential
- When the investor is ready to block the investment for a loner period of say about five years
- When the investor is ready to take the risk
- When the investor need to pay tax and falls under any one of the basic, higher or additional-rate category.

Drawbacks

Global Portfolio Management has its share of drawback too. The drawbacks are

I. Unfavourable exchange rate movement.

II. Frictions in international financial market

III. Manipulations of security prices

IV. Unequal access to information

Standardization vs Differentiation

- Standardization and Differentiation are the two sides of globalization. By standardization, we mean to show the global representation, while differentiation looks upon local competitiveness.
- So as Differentiation increases Standardisation decreases, conversely as Standardisation increases Differentiation decreases

Definition	Standardization involves offering the same products or services in multiple markets without making significant modifications.	Differentiation involves customizing products, services, or marketing strategies to meet the specific needs. and preferences of different markets..
Application in Marketing needs	Companies should apply 4Ps in the same way world wide.	It is supported by the strong market. variety by market individualism and uniqueness
Characteristics	It does not have special characters.	The product is differential from competitor's product.
Economics of scale	Higher productivity and lowers total cost.	Increasing cost of production and lower productivity.
Need	Satisfy the heterogeneous needs of the buyer.	Satisfy a specific need of buyer.
Management	Satisfy the heterogeneous needs of the buyer.	Fragmented and decentralized management with independent Country subsidies.
Example	Fast food chains like McDonald's often use standardized menus and processes across different countries.	Luxury brands like Louis Vuitton tailor their products and marketing strategies to appeal to the unique tastes of consumers in different regions

13.0 Global Entry Strategies

International business represents a dynamic and evolving field shaped by globalization, technological advancements, and geopolitical dynamics. By understanding the drivers, opportunities, and challenges of conducting business across borders, companies can formulate effective strategies to thrive in the global marketplace. Therefore it is essential to gain knowledge about different modes of entry and the determinants of the same of international business.

Determinants of modes of entry:

A firm adopts various modes for its entry into business transaction across borders. Which particular mode a firm should adopt depends, at least, upon four factors. They are:

1. Subservience of the corporate objective
2. Corporate capability
3. Host country environment
4. Perceived risk

Types of international business:

- EXPORTING
- COUNTER TRADE
- LICENSING
- FRANCHISING
- MANAGEMENT CONTRACTS
- MERGER & ACQUISITION
- FDI
- JOINT VENTURE
- CONTRACT MANUFACTURING
- STRATEGIC ALLIANCE

1. **EXPORTING:** One of the simplest and least resource-intensive methods, exporting involves selling goods or services produced in one country to customers located in another. It can take various forms, such as direct export, indirect export through intermediaries, or via e-commerce platforms.

It is further divided into:

A) Direct export: Direct export refers to the sale of goods or services produced by a company in one country directly to customers or businesses located in another country without the involvement of intermediaries such as agents, distributors, or trading companies. In this mode of entry into international markets, the exporting firm assumes full responsibility for marketing, distribution, logistics, and after-sales service in the foreign market.

B) Indirect export refers to the practice of selling goods or services produced in one country to customers or businesses located in another country through intermediaries such as export trading companies, agents, distributors, or third-party resellers. In this mode of entry into international markets, the exporting firm engages intermediaries to facilitate the sale and distribution of its products or services in foreign markets.

ADVANTAGES:

i. It allows less risk.

ii. It helps in distribution of surplus

DISADVANTAGES:

i. In Indirect export, the exporter has no control over the distribution of products

ii. Exporting through export intermediaries increases the cost of the product.

2. **COUNTER TRADE:** Counter-trade is a sort of bilateral trade where one set of goods is exchanged for another set of goods. In this type of external trade, a seller provides a buyer with deliveries and contractually agrees to purchase goods from the buyer equal to the agreed percentage of the original sale contract value.

ADVANTAGES:

- Absence of tariff barriers
- Stabilisation of export earnings
- Scope for benefits from trade diversification

DISADVANTAGES:

- Lack of encouragement for quality improvement
- Lack of double coincidence of goods to be traded
- Balancing of trade sometimes turns difficult

3. **LICENSING:** Licensing is an arrangement by which a fi rm transfers its intangible property such as expertise, know-how, blueprints, technology, and manufacturing design to its own unit, or to a fi rm, located abroad. It is also known as technical collaboration. A licence can be exclusive, non-exclusive, or cross. In an exclusive licence, the arrangement provides exclusive rights to produce and market an intangible property in a specific geographic region. On the contrary, a non-exclusive licence does not grant a firm sole access to the market.

ADVANTAGES:

- Expansion of operation in different countries
- Less risky

DISADVANTAGES:

- It can reduce the global consistency of the quality and marketing of a licensor's product in different national markets.
- The secrecy of technology is known to the licensee the moment the licensing agreement is made. In this way, a licensing arrangement hampers the very competitive advantage possessed by the licensor.

4. FRANCHISING: Franchising is a form of technical collaboration in which the franchisee makes use of intellectual property rights, like trademarks, copyrights, business know-how, managerial assistance, geographic exclusivity, or of a specific set of procedures of the franchiser for creating the product in question. It is a form of technical collaboration in which the franchisee makes use of intellectual property rights, like trademarks, copyrights, business know-how, managerial assistance, geographic exclusivity etc.

It is categorized into:

Direct franchising and Indirect franchising.

ADVANTAGES:

- Less risky
- It ensures highly motivated employees

DISADVANTAGES:

- Difficulty in keeping trade secrets.
- Franchisee may become a future competitor.
- A wrong franchisee may ruin the company's name and goodwill.

5**. MANAGEMENT CONTRACTS:** In a management contract, one company supplies the other with managerial expertise. Such agreements are normally signed in case of turnkey projects where the host country firm is not able to manage day-to-day affairs of the project, or in other cases where the desired managerial capabilities are not available in the host country. The transfer includes both technical expertise and managerial expertise.

Merits and Demerits: It is through management contracts that many developing countries are able to utilise specialised expertise in different areas of their economy. But the moment local talent is developed, management contracts lose their significance. Management contracts often supplement the licensing agreement insofar as they help the firm reap the advantages of licensing. Suppose a firm gets improved technology but lacks managerial inputs for better marketing, its products will remain unsold and the ultimate impact of the licensing agreement will be zero.

6. **Turnkey Projects:** In a turnkey project agreement, a firm agrees to construct an entire plant in a foreign country and make it fully operational. It is known as turnkey because the licensor starts the operation and hands over the key of the operating plant to the licensee. Agreements for turnkey projects normally take place where the initial construction part of the plant is more complex than the operational part. Such projects are either self-engineered or made to specifications. In case of the former, it is the licensor who decides the design of the project. In the latter, it is the licensee who takes such decision. In both cases, the contract involves either a fixed price or a cost-plus price. In a fixed-price contract, the risk of cost overruns lies with the licensor.

Advantages and Disadvantages: Turnkey projects allow firms to specialise in their core competencies, which they could not have done in the absence of such contracts. Moreover, such contracts allow the host government to obtain world class designs for its infrastructure projects. Turnkey projects are also advantageous in cases where the host government restrict the inflow of capital.

7**. Foreign Portfolio Investment and Foreign Direct Investment:** Foreign portfolio investment is an investment in the shares and debt securities of companies abroad in the secondary market merely for sake of returns and not in the interests of the management of the company. Foreign direct investment in form of green-field investment is an investment in the equity capital of a company abroad for the sake of the management of the company or investment abroad through opening of the branches.

* Green field investment takes place either through opening of branches in a foreign country or through financial collaborations.

* The term "brown-field" investment is used to denote a combination of green-field investment and M&As. It is found in cases when a firm acquires another firm; and after the acquisition, it completely replaces the plant and equipment, labour, and product line.

8. **MERGER & ACQUISITION:** A merger is a combination of two or more district entities into one, the desired effect being a accumulation of assets and liabilities of distinct entities and several other benefits such as economies of scale, tax benefits, fast growth, synergy, diversification, etc. The merging entities cease to be in existence and merge into a single servicing entity.

❖ Merger and acquisition are of three types:

  - ♦ Horizontal
  - ♦ Vertical
  - ♦ Conglomerate

Advantages:
-It supports low cost of production.

-Development of medium and small scale industries.

-No dilution of control.

Disadvantages
– Difficulty in maintaining quality standards.

– Local manufacturers in foreign markets may lose business.

9. JOINT VENTURE: It is a strategy used by companies to enter a foreign market by joining hands and sharing ownership and management with another company. It is used when two or more companies want to achieve some common objectives and expand international operations.

Advantages:
-Technological competence.

-Optimum use of resources.

-Partners are able to learn from each other.

Disadvantages:
-Conflicts over asymmetric investment.

-Cultural and political stability may pose a threat to successful operations.

-Conflicts in management.

10**. CONTRACT MANUFACTURING:** When a foreign firm hires a local manufacturer to produce their product or a part of their product it is known as contract manufacturing. This method utilizes the skills of a local manufacturer and helps in reducing the cost of production. The marketing and selling of the product is the responsibility of the international firm.

11.**STRATEGIC ALLIANCE:** It is a voluntary formal agreement between two companies to pool their resources to achieve a common set of objectives while remaining independent entities. It is mainly used to expand the production capacity and increase market share for a product. Alliances help in developing new technologies and utilizing the brand image and market knowledge of both companies.

CONCLUSION:

As globalization continues to reshape the business landscape, companies must remain vigilant and proactive in navigating the complexities of international markets. By understanding the nuances of different modes of entry and leveraging strategic insights, organizations can unlock new growth opportunities, enhance competitiveness, and build sustainable global operations.

MODULE III

14.0 STRATEGIC PLANNING AND FORMULATION

After a firm decides to involve itself in international business through any of the entry modes, it begins devising a strategy to achieve the goal of maximising corporate wealth. There are different approaches to devising strategies. The international manager relies on any one, or a combination, of strategies. Moreover, the strategy varies from case to case. In some cases, the parent unit likes to have a greater say in the functioning of the entire organisation, which means a great deal of centralised decision making. In others, the parent unit does not interfere much with the subsidiaries' performance, which means the subsidiaries have reasonable amount of freedom. Irrespective of the approach, the strategy is set by the process of planning. Planning shapes the strategy as well as defines the means to attain the goal. Thus, there is a close link between the goals of the firm, strategy and the process of planning. The formulation of strategies, the process of planning and control, and the organisational structure are much more complex in international business than in a domestic business. It is because international firms operate in a heterogeneous environment. In some cases, they enjoy some privileges, while in others, they have to face tough challenges. This is why any discussion regarding these issues is of much concern for international business.

- **WHAT IS STRATEGY IN INTERNATIONAL BUSINESS?**

Strategy is a managerial action to attain specific goal of a firm and the strategy of a firm is of course to achieve superior performance (competitive advantage) on a sustainable basis.

- **DIFFERENT APPROACHES OF STATEGIC FORMULATION:-**

Porter (1985, 1986, 1990)

(a) Selection of an appropriate generic strategy

– Cost leadership

– Product differentiation

– Focus on a specific segment of a market

(b) Application of the generic strategy for international business

– Configuration

– Coordination

Porter (1985) is of the view that a firm's competitive advantage depends on the selection of the most appropriate generic strategy, which incorporates three elements, namely, cost leadership, differentiation, and focus. If the cost of a product is lower than the competitors', the firm can maximize its sale/profit. Similarly, if the product is unique, differentiated from the rivals' product, and it meets consumers' preference, the firm will be able to maintain an edge over its rivals. Again, if the firm has focus on a particular segment of the market, either with a low-cost product or a differentiated product, the concentrated effort will definitely confer a competitive advantage upon it.

Porter (1986, 1990) developed the generic strategy theory for international business through the incorporation of the concept of configuration and coordination. The concept of configuration is based on the value chain concept. It shows whether it is better to concentrate the manufacturing activities in one or two nations and cater to the outside demand through export, or to disperse the manufacturing activities over a number of countries. However, Porter is of the view that configuration alone does not assure competitive advantage unless and until the activities in different countries are properly coordinated.

Prahlad and Hamel (1990); Kay (1993)

Development of core competence

– Unhindered availability of least-cost resources

– Better network of relationship within and outside the fi rm

– Improved features of product

– Improved communication links with the consumers

– Improvement in the market position

The other approach, which has been developed by **Prahalad and Hamel (1990)** and **Kay (1993)** is known as competence-based strategy. It is the core competence or the distinctive capability of the firm that puts it in a superior position. Core competence can be possessed if the resources—physical, financial, technological, and human—are available at the least cost, conveniently and, without interruption. Again, the existing core competence can be strengthened and new core competence can be built up.

Kay is of the view that core competence can be improved through,

(1) Better network of relationship within and outside the firm.

(2) Improvement in the quality and features of the product and in communication links with the consumers.

(3) Improvement in the market position.

Yip (1992)

Adoption of total global strategy

– Development of core business strategy

– Internationalisation of core business strategy

– Coordinating activities of the fi rm in different countries

Yip (1992) talks about the total global strategy. He suggests a three-stage move towards total global strategy. In the first stage the core business strategy is developed, which includes decisions on type and pricing of product, customers, markets, and so on.

In the second stage, the core strategy is internationalized, which involves, inter alia, adaptation of the product for the global market. Lastly, in the third stage, all the activities of the firm, in different countries, are integrated. This way Yip supports the two views mentioned above but placesgreater stress on the global aspect.

SPECTRUM OF STRATEGY FORMULATION: -

The **spectrum** of IB strategy deals with:

1. Sources of funds,

2. Location of manufacturing (Political and economical scenarios)

3. Market and product diversification.

- Market diversification because of firm specific advantage, unprofitable at home, new product stage in foreign country.

- Product diversification upstream or downstream.

LEVELS OF STRATEGY FORMULATION:-

- Perlmutter (1967) suggested three broad type of strategies
    - Ethnocentric (dominance of the parent company)
    - Polycentric (decentralised management strategies and subsidiaries are not connected to each other)
    - Geocentric (lies between ethnocentric and polycentric)

It was Perlmutter (1967) who suggested that three broad and distinct types of strategies—ethnocentric, polycentric and geocentric shaped the structure of international fi rms. In his view, ethnocentrism is compatible with dominance of the parent company over the entire network of the firm. Since products are uniform throughout the world, bulk production is possible, which reaps economies of scale, which in turn fosters the competitive power of the fi rm. But the greatest demerit of this strategy is that markets requiring adaptation of the product in order to suit the consumption pattern of the local consumers is out of reach for the fi rm. Moreover, ethnocentrism can lead to problems connected with industrial relations and can hamper the fi rm's relations with the host government. Polycentrism is opposite to ethnocentrism and so it is opposed to centralised control. It means that polycentric international fi rms have free standing subsidiaries that do not have much operational linkage among themselves or with the parent unit. Their Products are not standardised. They are adapted freely to suit the local demand in different countries, with the result that the price decision is taken by the subsidiaries, which are often more aggressive while taking such decisions. The relative freedom enjoyed by the subsidiaries does not mean that this strategy is not going to confer benefits on the parent unit. The parent unit does reap benefit from geographic diversification. Since economic conditions in different countries often vary, the revenue stream of different subsidiaries is often negatively correlated and, as a result, there is stability in the revenue stream, which reduces risk with a given return. Besides geographic diversification, there is also product diversification in the form of a more dispersed production structure, which reduces the risk with a given return. All this does not mean that revenue does not rise. Because of freedom in pricing, according to what is suitable to individual markets, revenue can be maximised and huge profits can be generated. An ethnocentric firm cannot generate profits in this manner. However, the greatest demerit polycentric organisations suffer from is that the communication medium among the subsidiaries or with the parent units gets weaker and, as a result, potential synergies are not realised. however, the products of a particular subsidiary are not accepted universally. The firm is not known throughout the world by its brand name. Geocentricism lies between the two—ethnocentrism and polycentrism. It means that this strategy, like ethnocentric strategy, has a global perspective aiming at maximising the global profit, but at the same time, like a polycentric strategy, it has a multi-product production system. This strategy reaps the benefits of both the strategies discussed above and so it is more proximate to real life.

Corporate level Strategy: Companies having more than one line of business formulate a corporate level strategy that coordinates the different business level strategies. Since business level strategies may differ among themselves, it is necessary to formulate a corporate level strategy so that none of the business level strategies go against the corporate level strategy. The corporate level strategy may stress growth, retrenchment, or stability, or a combination of the three. However, a combination of strategies can also be formulated when the corporate strategy allows successful business lines to grow, unsuccessful business lines to cut short their activities, and allows still others to maintain stability.

Business level Strategy: If the company has only one line of business, a business level strategy is not formulated. But it becomes essential in cases where there is more than one line of business. Although the purpose is served by the corporate level strategy, the business level strategy is formulated for either minimising costs or for differentiating the product by adding special features therein. The cost minimising strategy, normally possible either through the achievement of economies of scale or through the use of cost-reducing technology, may help grab a larger share of market and enhance the total profit. This strategy is more useful when the demand for the product is highly price elastic.

Department level Strategy: The efficacy of the department level strategy is a prerequisite for sound corporate level/business level strategy. This is because, at the department level, customer value is created through low cost and differentiated products. Primary activities—consisting of manufacturing activities, logistics, and marketing activities—have a crucial role to play in lowering the cost or in making a differentiated product.

INTERNATIONAL STRATEGY PLANNING

The **process of planning** seeks to answer question regarding what the firm expects to achieve and what method the firm is going to use to this end.

In a small firm, planning may be ad hoc. But in large firms, especially in multinational corporations that operate in varying environments, the process of planning is more systematic and comprehensive.

The process of planning may be short term or long term. The former is known as operating planning and is concerned with day-to-day operations. On the contrary, long term planning, called strategic planning, precedes the operating planning. Moreover, strategic plans are broader and more comprehensive.

Steps in the Process of Strategic Planning:-

There are different steps in the process of strategic planning, which are adopted in sequence, although sometimes they occur simultaneously. The steps are:

1. Assessment of the external environment and internal resources

2. Formulation of global strategy

3. Development of global program

4. Centralised vs. Decentralised planning

1. Assessment of the external environment and the internal resources:

The assessment of the external environment has a greater relevance in-case of an international company as host countries present varying environments. The assessment takes into consideration the present position and the future trends in relation to the size of the market,

consumption pattern in different markets, the intensity of competition, and the business linkages in different markets .When the assessment of external factors is complete, the firm assesses how far the resources available at its disposal are able to meet the desired objectives. If the resources fall short of the requirements, the firm plans for supplementing them. The assessment of resources includes that of financial resources, human resources, and product resources. For the assessment of financial resources, the firm evaluates the present and future cash flows, availability of capital, ability to transfer funds from one unit to the other, and the profits and dividend target .Similarly, human resource assessment is concerned with the of skilled persons and their attitude towards employment in a foreign country. Apart from the financial and human resources, the firm has to assess whether its product can be adapted to the requirements of the host country's consumption pattern. The assessment takes into consideration some other factors too, such as the capacity utilization, monopolistic characteristics of the product, economies of scale, transportation facilities, and so on. This is because these factors are very important from the viewpoint of establishing competitive advantage.

2. Formulation of global strategy:

This strategy involves the market as well as the product. As far as the market strategy is concerned, a suitable market representing a sufficiently large demand for the product or having

the least competition is selected. The ease with which the parent company can allocate resources is yet another factor that influences market selection. Also, a foreign market that has some kind of resemblance with its existing markets is preferred, as in this case, it will be easier for the firm to cope with the market demand.

Apart from the market strategy, product strategy also needs formulation. In case of product strategy, the emphasis lies on a single product vis-à-vis a multiple product strategy. Single product theory is advocated on the grounds of economies of scale, awareness of the consumers, and market leadership. Product differentiation, on the other hand, helps the firm reap oligopolistic advantages, although the process of differentiation may lead to cost escalation. Thus, it is evident that combining product differentiation with cost containment and, thereby, in expanding the market share is the best strategy.

3. **Development of global program:**

This step includes planning, mainly with the respect to the degree of product standardisation, marketing program, and location for production. Both standardisation of product and adaptation of product have merits and demerits. Therefore, the firm needs to assess how much adaptation/ standardisation of the product can be recommended so as to achieve economies of scale and at the same time attract the consumers abroad. Similarly, planning is done with respect to marketing and advertising techniques—whether they should be uniform in different countries or different for different countries. It of course takes into account the disparity in the taste of the consumers in different markets. Again, the firm plans the location of the plant and the service centre based on a couple of factors. The first factor is the cost consideration, while the second is consumer convenience. In fact, it is because of the cost consideration that international concerns have started manufacturing in the developing countries where labour or raw material is cheap. Planning

offshore production is a case in point. However, the cost of transport to carry the manufactured goods to the market centre and making the products easily available to the consumers cannot be overlooked.

4. **Centralised versus Decentralised Planning**

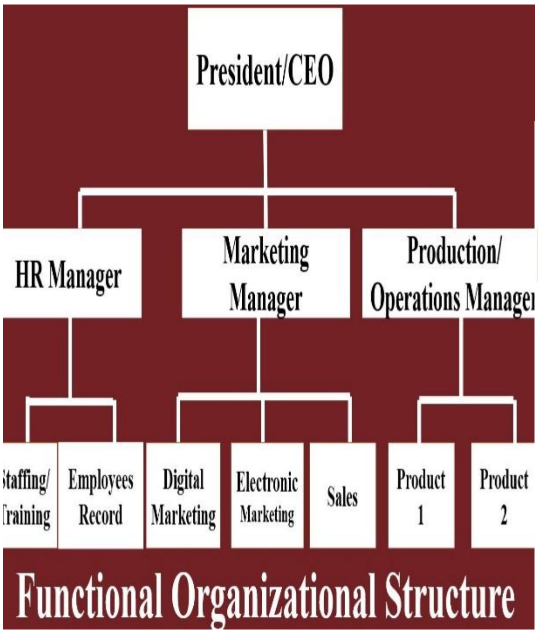
When decisions related to the process of planning are taken at the parent office it is known as centralised planning. On the contrary, when the planning process evolves at the subsidiary level, it is called decentralized planning. In real life, neither of the two exists in its purest form. There is usually a combination of the two. When a product involves intricate technology developed at home, it is often globally standardised. And, in this case, the planning is carried on at the parent unit, the subsidiaries have virtually no say in the decision. Again, when different units of a firm are closely interlinked and when host governments do not impose control over the cross-border mobility of funds and other factors of production, it is often due to centralized planning.

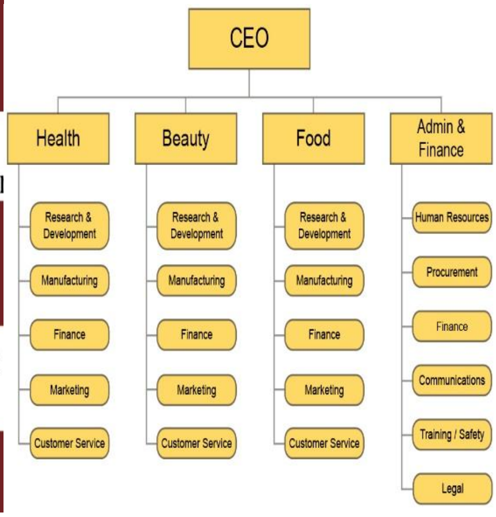
Organisational structure

- Organisational structure is a structure of linkages among organs of a firm establishing the route and locus of decision making. The structure of an organisation becomes complex with the growing degree of internationalisation.
- The structure is either a functional structure or a product structure.

❖ Absence of Formal Organisational Structure

In the beginning, when a firm has just begun international transactions, and that too on an ad hoc basis, meaning that the export is only fortuitous, it is the domestic division that handles export. The organisational structure is not different from that of a domestic company despite occasional involvement in international business. The structure is either a functional structure or a product structure. In a functional structure, below the chief executive officer, the organisation is divided into different functional divisions, such as marketing, finance, production, and so on and power centres are located in these different divisions. The figure(1) shows a functional structure. On the other hand, in a product structure, below the chief executive officer, the organisation is divided into different product groups that allows the firm to segment internal operations in order to comply with product and market variations. Figure(2) shows a product structure.





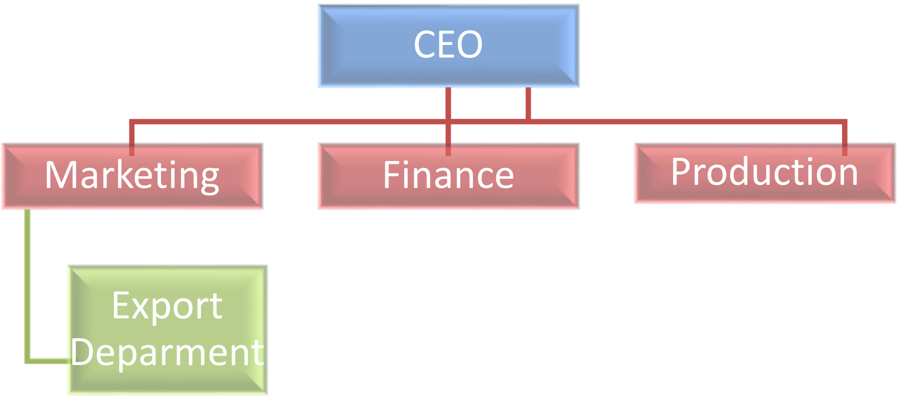
Figure(1) Figure (2)

❖ Creation of Export Department

The organisational structure changes the moment the firm begins exporting on a continuous basis. Export activities do not remain fortuitous, rather they are deliberate. In such cases, the firm may set up an export department as a sub-department of marketing, manned by experts in the field of

international business. If the international business becomes a permanent phenomenon, the export department will have some freedom to operate and an international organisational structure will begin to emerge. Nevertheless, priority in this type of organisation is mainly the domestic market, rather than on the foreign market, with the result that the domestic marketing department maintains an overall control over the export department.

The figure given below presents a clear picture of this type of structure.



❖ **International Division**

With exports moving on to a stronger footing and sometimes with growing competition for the same market, the firm's attitude towards the organisational structure changes and it sets up an independent functional division, that is, an international division that assumes the entire responsibility for international business. It may be a part of the fi rm; or it may be incorporated as a separate entity, depending upon how the objectives of the fi rm are accomplished more easily.

❖ **Global division**

When a firm starts its foreign operation, the foreign subsidiary may need transfer of technology or certain components, which means considerable attention to the foreign operation.

The global division is classified on the basis of

– Product structure
– Area structure
– Functional structure

–

Customer oriented structure

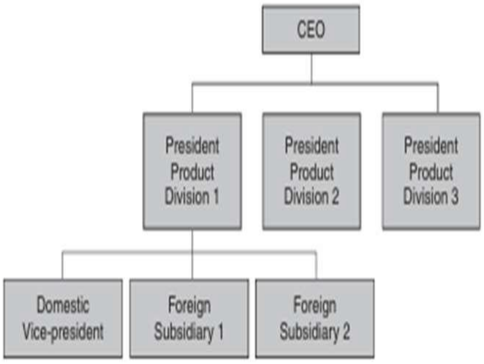


FIGURE 14.5 Global Product Structure

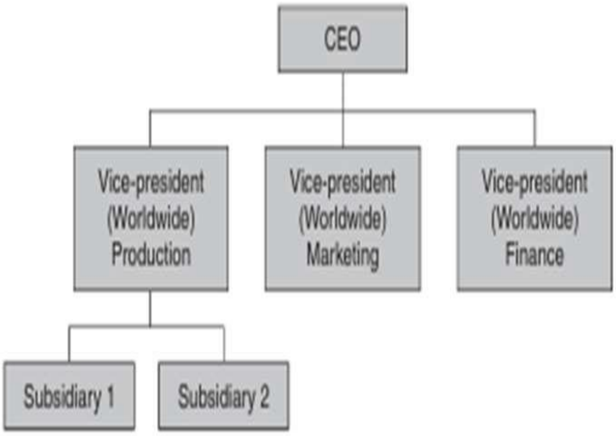


FIGURE 14.7 Global Functional Structure

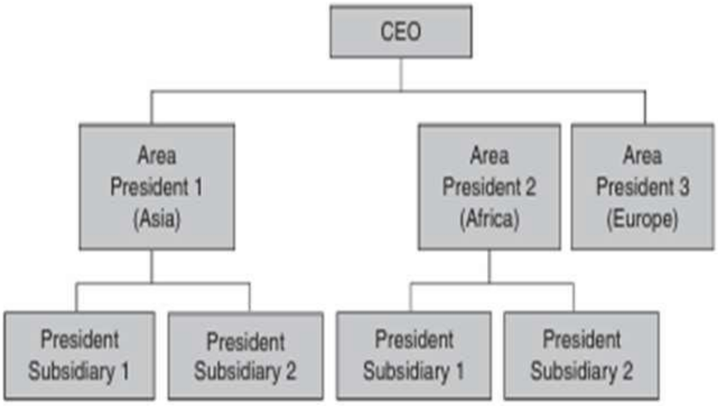


FIGURE 14.6 Global Area Structure

❖ **Multidimensional/Matrix Structure**

- The global matrix structure integrates product, area, and functional aspects, making it more complex.

- Multi-product firms may adopt this structure when certain product groups require area-based organization, others require functional structure, and some benefit product-based organization.

- Firms reach this stage when economies of scale in production increase, and subsidiaries expand their market beyond traditional boundaries.

- In the global matrix structure, country-level managers report to both regional and product managers, achieving a balance between global/regional needs and local requirements.

- This structure promotes team collaboration, which is crucial when no single individual possesses all the necessary information.

- Figure 14.8 illustrates this type of complex organizational structure.

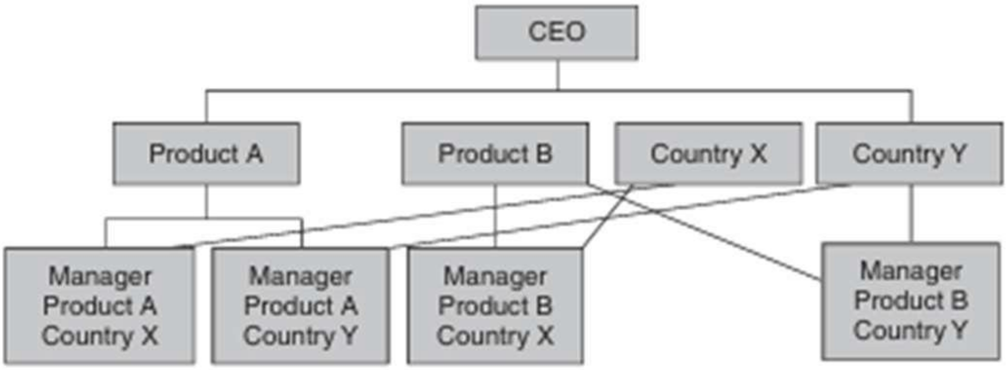


FIGURE 14.8 Matrix Structure

PROCESS OF CONTROL

- The control process involves examining facts to verify goal achievement.

- It identifies deviations from set goals and proposes measures to address them.

- Control is particularly crucial for multinational enterprises due to complex operations, large physical and cultural distances, and significant delegation of authority.

- Understanding the characteristics of an effective control system is essential in this context.

Features of an Effective Control System

- An effective control system relies on accurate information, comparing performance with a set standard.

- Differences in currency between the parent unit and subsidiaries can affect the reliability of information due to exchange rate fluctuations.

- Performance standards may vary across different business environments, requiring the firm to set standards that incorporate local variations while reflecting an overall company view.

- The control system should be cost-effective, balancing the need for refinement with the cost of

implementation.

- Too many refinements can increase the cost of the control system, potentially making it counter-productive.

- Frequent appraisal of the control system's cost-effectiveness helps maintain costs within manageable limits.

- Timeliness of information is crucial for effective control, but geographic distance and cultural attitudes can cause delays in international business.

- For example, Latin American cultures may not prioritize timeliness as much as cultures in the United States and the United Kingdom.

- Information should be objective, minimizing subjectivity to ease interpretation and facilitate unbiased decision-making in control strategies.

DESIGN OF CONTROL

Accounting and Audit Control:

- Analyzes past financial data using various accounting techniques like ratio analysis and cash flow analysis.

- Utilizes standard costing and variance analysis to assess material, labor, and overhead costs against set standards.

- Audit control verifies the reliability and validity of reported financial statements.

- Accounting practices vary widely across different countries, making it challenging to set uniform standards for performance evaluation.

Control through Plans, Policies, and Procedures:

- Also known as bureaucratic or formalized control.

- Involves both long-term and short-term planning, with short-term plans often accompanied by annual budgets.

- Actual performance is evaluated against set plans, and corrective measures are taken for any deviations.

- Long-term plans emphasize qualitative goals.

- Formalizes policies and procedures for the entire firm and its units, aiming for operational consistency while balancing global procedures with local regulations.

Cultural Control:

- Focuses on corporate values and culture to complement bureaucratic control.

- Relies on socialization and informal personal interaction to promote a homogenized corporate culture.

- Training plays a significant role in fostering better performance through acculturation.

Centralized and Decentralized Control:

- Centralized control maintains control over the entire firm from the parent unit, providing subsidiaries with minimal freedom.

- Decentralized control grants subsidiaries greater autonomy in their operations.

- Decentralization is preferred when subsidiaries have a marginal involvement in overall international business, among other factors.

- Centralization is favored in the face of global competitive threats or substantial involvement in research and development (R&D), among other scenarios.

15.0 Global production Strategy

Global Production

Meaning: Global production encompasses the entire value chain, from sourcing raw materials and components to manufacturing, assembly, distribution, and after-sales service. It reflects the increasing interconnectedness of economies and businesses in a globalized world, where companies leverage diverse locations, expertise, and capabilities to optimize production processes and serve customers worldwide.

In essence, global production entails the integration of manufacturing activities on a global scale, facilitated by advancements in technology, logistics, and trade, enabling businesses to operate across borders, access new markets, and capitalize on comparative advantages to remain competitive in the international marketplace.

Definition: Global production refers to the process of manufacturing goods and delivering services across international borders to meet market demands. It involves the coordination of resources, facilities, and activities distributed across multiple countries or regions, often driven by factors such as cost efficiency, market access, and strategic advantage.

KEY COMPONENTS:

- **Sourcing:** Obtaining raw materials, components, or services from different countries to leverage cost advantages or access specialized expertise.
- **Manufacturing:** Setting up production facilities or outsourcing manufacturing processes to locations with favourable labour costs, infrastructure, or regulatory environments.
- **Distribution:** Establishing networks for transporting finished products to various markets efficiently and cost-effectively.
- **Sales and Marketing:** Tailoring marketing strategies and sales approaches to different regions or cultures to maximize market penetration.

BENEFITS:

- **Cost Optimization:** Accessing lower production costs, labour costs, or tax incentives in different regions.
- **Market Access:** Expanding into new markets and reaching a larger customer base.
- **Risk Mitigation:** Diversifying production locations to reduce dependence on any single market or supplier.
- **Innovation:** Leveraging diverse talent pools and expertise from different regions to drive innovation.

CHALLENGES:

- **Supply Chain Complexity:** Managing complex supply chains spanning multiple countries, languages, and regulations.
- **Regulatory Compliance:** Navigating varied legal and regulatory frameworks, trade barriers, and customs procedures.
- **Cultural Differences:** Understanding and adapting to cultural nuances in different markets, including consumer preferences and business practices.
- **Logistical Risks:** Dealing with transportation delays, geopolitical instability, or natural disasters that can disrupt production or distribution.

STRATEGIES:

- **Outsourcing:** Partnering with third-party manufacturers or service providers in different countries.
- **Offshoring:** Establishing subsidiaries or production facilities in foreign countries to take advantage of local resources or markets.
- **Just-In-Time (JIT) Manufacturing:** Adopting JIT principles to minimize inventory costs and streamline production processes.
- **Technology Integration:** Implementing digital technologies such as IoT, AI, and blockchain to optimize supply chain visibility, efficiency, and resilience.

FUTURE TRENDS:

- **Reshoring:** Some companies may bring production back to their home countries to reduce dependence on overseas suppliers and mitigate supply chain risks.

- **Sustainability:** Increasing focus on sustainable practices and ethical sourcing across global production networks.

DIGITAL TRANSFORMATION: Continued adoption of digital technologies to enhance agility, productivity, and sustainability in global production processes.

Location for production

An international firm may have various alternatives regarding the location of manufacturing activities

Centralization of manufacturing operations at the parent unit or in any of the subsidiaries

Decentralization of manufacturing options at different subsidiaries

Location of the different parts of the manufacturing process at different subsidiaries under vertically integrated framework.

Factors behind location selection

Dunning (1980) mention 5 factors for selection of location

- Size and growth of market and degree of competition
- Availability of raw material and skilled labour
- State of logistics and degree of currency fluctuation
- Political and legal environment
- Cultural and linguistic environment

16.0 GLOBAL SUPPLY CHAIN ISSUES

The international supply chain is the process that goods and materials travel from their point of origin to the point of consumption. This process involves a complex network of suppliers, manufacturers, distributors, retailers, and customers that span the globe. The international supply chain is responsible for ensuring that goods and materials are delivered to consumers in a timely and efficient manner.

The international supply chain is a critical part of the global economy and plays a vital role in ensuring that businesses can operate across borders. Without the international supply chain, businesses would be unable The to source goods and materials from overseas markets or sell their products in foreign markets. The international supply chain is therefore essential for businesses that want to tap into new markets and expand their operations globally.

The international supply chain is also responsible for delivering goods and materials to regions where they are needed most. For example, the international supply chain ensures that relief aid reaches disaster-stricken areas in a timely manner. The efficient functioning of the international supply chain is essential for maintaining global economic stability and promoting economic growth.

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Global supply chain management in international business faces various challenges, including:

•Logistical Complexity: Managing the movement of goods across borders involves navigating complex transportation networks, customs regulations, and different infrastructures.

•Inventory Management: Balancing inventory levels across multiple locations to meet demand while minimizing costs and avoiding stockouts or overstocking is a constant challenge.

•Supplier Relationships: Building and maintaining strong relationships with suppliers worldwide requires effective communication, negotiation skills, and cultural sensitivity.

•Risk Management: External factors like geopolitical instability, natural disasters, and economic fluctuations can disrupt the supply chain. Mitigating these risks requires contingency planning and diversification of suppliers.

•Quality Control: Ensuring consistent product quality across various locations and suppliers can be challenging due to differences in manufacturing processes, standards, and regulations.

•Information Technology: Leveraging technology for real-time visibility, data analytics, and communication is crucial for effective supply chain management, but implementing and integrating systems globally can be complex.

•Sustainability and Ethics: Meeting environmental and ethical standards throughout the supply chain is increasingly important for businesses, but it requires monitoring and enforcing compliance across multiple suppliers and regions.

Addressing these challenges requires a combination of strategic planning, operational excellence, technological innovation, and effective collaboration with partners and stakeholders.

Inventory management

- In an international firm, inventory management is complex because of longer transit time, lengthy customs procedure, political risk as well exchange risk.
- Deviation from EOQ- To arrive at EOQ firm has to trade off between carrying cost and ordering cost. Domestic firm adheres to EOQ strictly but international firm normally possess bigger stock than EOQ. This is called as stockpiling. If the probability of interruption in supply is very high, the firm may go for stockpiling even if it is justified on the grounds of higher cost.
- Shifting of reorder point – Reorder point lies much earlier in view of larger lead time and lengthy custom formalities
- JIT systems – The rational of just in time system is that the input like raw materials, spare part and components should reach the production just in time so that the carrying cost is reduced to the minimum. However in view of the complexity if international business it need little longer transit time.

Sourcing of inputs

- The broad objective of the input sourcing decisions are cost minimization, regular and uninterrupted supply, quality advantage, risk minimization
- Modes of procurement – Procurement is centralized or decentralized. There are three modes of procurement
  - Importation
  - Establishment of international procurement offices
  - Sourcing through direct investment

- Make or buy decision – it refers to procurement of inputs from within the firm/from outside sources.
- **Advantages of make within the firm –**
  - Full control over the quality and timing of supply
  - Availability of input at lower cost
  - Easy modification in design
  - Secrecy is mantained
  - Generation of profit through arbitrage pricing of inputs.

Advantages of buying inputs from outside

- No additional investment for input manufacturing
- No need for acquiring technology for input manufacturing
- Freedom to get inputs from cheapest sources
- Diversification of sources of inputs leading to low political and exchange risk.
- Operational flexibility in face of changing demand

17.0 International Market Strategy

Global marketing is defined as the process of adjusting the marketing strategies of your company to adapt to the conditions of other countries. It is the full process of planning, creating, positioning, and promoting your products in a global market. Global Marketing combines the promotion and selling of goods and services with an increasinglyinterdependent and integrated global economy. It makes the companies stateless and without walls.

- **Market identification and demand estimation**

i. Identification of potential market

ii. Screen the market on the basis of economic variables like income, interest rate, inflation, expected ROI, availability of credit

iii. Examine the market on the basis of political and legal environment

iv. Screen socio cultural environment

v. Screening the level of competition

vi. On the spot study after first five screenings

- **Estimation of demand** – size of the total demand and possible share of firm's own product.

i. Firm analyses economic and non economic variables like market size depending on size of the population, market intensity depending on the level of per capita income, market consumption capacity depending elasticity, commercial infrastructure

ii. Demand for the product may change over time.

iii. When the size of the potential demand is estimated for the selected markets, these markets are listed in order of preference so that the greater emphasis may be placed on markets where potential demand is greater.

Product Strategy

Standardization Vs Adaptation : Whether product should be standard product or an adapted product.

- Standardization means the features of the product should be homogenous for all markets. On the contrary in adaptation the product undergoes modification for different markets.

Advantages of standardization
- Economies of scale
- Consistency in product image
- High technology product compatibility
- Universal demand product like watches
- Factors behind adaptation

There are host of factors like government regulations, environmental conditions, local use conditions, space constraints, income level of the consumers leading to the adaptation of products.
- Related to the features of the product
- Related to the features of a particular market
- Related to firm's own decision

Challenges in Product Development

Companies now need to consider the challenges of international distribution in the initial product development process.

i. Social Challenges

Products are developed to meet a specific need or want. Just because we have a need or want it doesn't mean that need or want is universal. Different countries are at different stages of economic development, and the need or want we have, might not have developed in enough other countries to create a viable target market.

ii. Distribution Challenges

In America, if you can get Wal-Mart and Target to carry your product, you have instant national distribution. Most other countries don't have that type of national distribution available to them. You have to work with dozens of regional chains, distributors and independent stores. Many countries, such as India, have large outlying areas that are served by thousands of small mom-and-pop stores. It can be a real challenge to get your product from the import docks to a place where a customer can buy it.

iii. Promotional Challenges

In America, they have a variety of effective methods to promote a product and communicate with the customers. We can use television, radio, direct mail, magazines, social media, billboards, telemarketing and product placement in movies. Many other countries just don't have these promotional methods, certainly not to the extent we have here.

Pricing

International pricing should cover all costs, meaning that the price should be equal to the sum of domestic price and overseas cost

Strategy of pricing
- Uniform pricing between home and host countries
- Price difference between home and host countries
- Skimming or penetration pricing
- Bundling or unbundling pricing
- Dumping
- Price control by government
- Transfer pricing
- Price discrimination - It refers to different prices for different markets or different segments of the same market
- Skimming and penetration price – Charging a higher price in the beginning followed by lower prices later is price skimming. Penetration pricing is just the reverse
- Bundling or unbundling of product – Higher price for bare-bone items and lower prices for accessories is bundling of a product. Unbundling is reverse.
- Dumping : There are 3 types of dumping
- Sporadic dumping – Manufacturer, in order to eliminate stock of goods, sells the product at throw away price
- Predatory dumping – Penetrate a new market and throw out the competition to

establish monopolistic position.
 Persistent dumping – When the product is highly price elastic abroad, the firm adopts full cost pricing covering the fixed cost for domestic market and marginal cost pricing abroad.

 Transfer pricing- It is arbitrary pricing of exports and imports that may be greater than

or less than the arm's length prices.

- There are many forms of transfer prices. When pre-tax profit of a unit located in a high tax country is shifted through transfer pricing to an another unit of the same firmlocated in a low tax country, it is called money transfer pricing
- If the objective is to maximize the aggregate net output of the firm, the price of intermediate goods is designed to boost up the production. This is called as efficient transfer pricing

International Pricing Challenges

Global firms face the following challenges while pricing their products and services to suit

the requirements of international market −

i. Export Price Escalation − Exporting includes more steps and higher risks than domestic sale. To make up for shipping, insurance and tariffs, and foreign retail prices, the export price may be much higher than domestic country. It is important to know whether external customers are willing to pay an additional price for the products/services and whether the pricing will be competitive in that market. If both answers are negative, then there are two approaches. One is to find a way to decrease the export price, and the second is to position the product as an exclusive or premium brand.

ii. Inflation − Intense and uncontrolled inflation can be a huge obstacle for MNCs. If inflation rates are rampant, setting prices and controlling costs require full dedication of marketing and financial divisions. Some alternatives to counter inflation include changing the components of products or their packaging, procuring raw materials from low-cost suppliers and shortening credit terms, etc.

iii. Currency Movements − Exchange rates being unstable, setting a price strategy that can get rid of fluctuations gets difficult. Key considerations include what proportion of exchange rate gain or loss should be transferred to customers (the pass-through issue), and finding which currency price quotes are given in.

iv. Anti-dumping Regulations − Dumping occurs when imports are sold at an unfair and very low price. Recently countries have adopted anti-dumping laws to protect their local industries. Anti-dumping laws should be considered when deciding global prices.

Price Coordination − Price coordination is the relationship between prices charged in different countries. It is an important consideration while deciding the global pricing model. Price coordination includes the following factors − Nature of customers, Product differentiation amount, Nature of distribution channels, Competition type, Market Integration, Internal organizational characteristics, and Government regulations.

vi. Countertrade − Countertrades are unconventional trade-financing transactions including non-cash compensation. A monetary valuation can however be used in countertrade for accounting purposes. In dealings between sovereign states, the term bilateral trade is generally used. Examples include clearing arrangements, buybacks, counter purchases, switch trading, and offsets.

Production and Channelisation

Production:
Production: Production refers to manufacturing, acquiring, and developing products for the business market.
Global Production: Production is the core of any business organization having its operations

on an international scale. International business firms must look closely at production factors
for profitability and sustainability.
The foundation for international production and operations is no different to domestic production and operations management. But there are certain aspects which make international exposure a challenge for an organization.
As IPOM is dynamic in nature, organization has to design it strategic objectives which cover
following points:

▪ Meeting international quality standards
▪ Forecasting demand and production design
▪ Profitability
▪ Minimum production cost
▪ Adaptation to modern available technology

Distribution:
As far as distribution is concerned, an international business should address two issues:
1. Selecting channels of distribution.
2. Selecting the modes of transportation for shipping goods from their point of origin to their destination.

Channels of Distribution

Firms make use of two principal channels of distribution when marketing abroad: (1) indirect

selling, and (2) direct selling.

(1)Indirect Selling - Indirect selling, also known as local or domestic channel, is employed when a manufacturer markets its products through another firm from the same country that acts as intermediary. As such, the sales intermediary is just another local or domestic channel because the manufacturer has no dealings with a foreign firm.

• By exporting through the local intermediary, the manufacturer avoids setting up of an international department. The intermediary, acting as the manufacturer's external export organisation, assumes the responsibility for moving the product overseas.

• With an indirect channel, a manufacturer does not have to correspond with the foreign parties in foreign countries. Instead, the manufacturer deals with one or more domestic middlemen, who in turn move and/or sell the product to foreign middlemen or final users.

(2) Direct Selling – Direct selling is employed when a manufacturer develops an overseas channel. Here, the firm deals directly with a foreign party without going through an intermediary in the home country. The firm must set up the overseas channel to take care of the business activities between the countries. Being responsible for shipping the product to foreign markets itself, the firm exports through its own internal export department or organisation.

Modes of Transportation

• To move a product both between countries and within a country, three fundamentals means of transportation are available: air, water (ocean and inland), and land (rail and truck). Ocean and air shipments are appropriate for moving goods across the countries, especially when the distance is considerable and the boundaries are separated.

• When national markets are connected by land (e.g., North America), it is possible to use rail and highway to move merchandise from locations such as from the US to Canada.The appropriate transportation mode depends on (1) market location, (2) speed, and (3) cost.

 Market Location - A firm must consider market location. To move goods between continents, ocean or air transport is needed.

 Speed - Speed is another consideration. Where speed is most important, air transport is the preferable means of distribution. Air transport is also necessary when the need is urgent or when delivery must be quickly completed as promised.

 Cost - Cost also needs consideration as well. Cost is related to speed-speedier the means, costlier does it become. But there is a trade-off between the two in terms of other benefits. Packing costs for air freight are less than for ocean freight because for air freight the merchandise does not have to be in transit for a long period of time, and the hazards are fewer.

Factors Affecting Choice of Channels

Channel of distribution or middlemen selection must precede the understanding of the characteristics of the foreign market and the established common system there. The major factors to consider while choosing a particular channel are −

 The specific target market within and across countries.

 The goals in terms of volume, market share, and profit margin.

 The financial and organizational commitments.

 Control of the length and characteristics of the channels.

 Application of 4 P'

Market concentration Vs Market diversification

- Market concentration is based on focusing on a particular market confined to small area and market diversification spread over a large area.
- There may be segment diversification in market concentration on the contrary market diversification strategy segment concentration strategy may be followed

18.0 Documents required for export and import transaction:

Generally, three types of documents are required for international business such as:

- Letter of credit
- Draft
- Bill of lading

1.Letter of credit (L/C):

- Letter of credit is a bank's promise to pay issued by a bank at the request of an importer (the applicant/ buyer) in which the bank promises to pay an exporter (the beneficiary of the letter) upon presentation of documents specified in the L/C.
- An L/C reduces the risk of non-completion, because the bank agrees to pay against documents rather than actual merchandise.
- L/C can also be a source of settling international transactions, as explained earlier. Bank will also be in a position to finance parties involved in import and export based on goods-in-transit.
- Banks come forward to finance goods-in-transit only after the risks associated with non-completion and foreign exchange fluctuations removed.

Here are the main documents letter of credit applications require.

- Commercial documents — Invoice, packing list
- Financial documents — Bill of exchange
- Shipping documents — Bill of lading
- Airway bill, lorry/truck receipt, railway receipt, forwarder cargo receipt
- Official documents — License, origin certificate, inspection certificate
- Insurance documents — insurance policy or certificate,

Commercial Invoice - The commercial invoice is a type of legal document used in international trade. Exporter or seller will issue this paperwork as a proof of the sale of goods. it is a type of document that works for import clearance processes. It also includes prices of goods and details about the specific terms of sale, plus the quantities or amount of goods you are importing, information about your business, and the exporter’s details. With a commercial invoice, your bank can ensure the details match the information on the letter of credit. Your bank will also ensure the currency designation is the same as the currency stated in the letter of credit before releasing your payment to the exporter.

Packing Lists - This paperwork provides the number of containers and shipping marks. It also features additional information, such as the weight of the package, the package’s markings, information about the carrier, exporter, and importer, a goods description, and the package type. It typically does not feature financial details. With this paperwork, your bank can verify that the exporter has packaged the goods correctly. It helps guarantee that the goods are correctly shipped and protects your interests as an importer.

Bill of exchange / Draft - We will need to provide our bank with a bill of exchange, legal paperwork specifying that you will pay the exporter at a specific date in the future. it will specify the amount you will pay and the payment date. it also includes additional details such as the exporter’s information, the date of issuance, and information about how the payment should be completed.

Certificate of Origin - With a certificate of origin, you receive information about which country the manufacturer made the goods. More importantly, your bank can check whether the items align with the country of origin's regulations before you pay for them. This is one of the letters of credit required documents that help banks ensure no trading restrictions apply to the country of origin. It also ensures your company and bank can determine custom tariffs, which are expenses related to imports from other countries

Inspection Certificate - The inspection certificate proves that official bodies have inspected the goods. The official body that completes the inspection is typically an independent firm or third party. These documents reduce the chances of fraud and ensure that your business receives goods that align with the quality described in the letter of credit. Therefore, it ensures your business is protected against poorquality goods. Your bank will confirm that the goods align with the required standards before they pay the seller or exporter. In other words, they will use this document to ensure the third-party firm has verified the goods’ quality before issuing payment.

Insurance Certificate - Your business will need to provide insurance certificates with your application for a letter of credit for the goods you receive. You can request this paperwork from the seller or exporter, and it covers your company against potential issues with goods. For example, an insurance certificate covers you if the goods are lost in transit. They also cover your company if the goods are damaged during shipping. The cover specified in the insurance certificate should match the risks outlined in the letter of credit. The insurance cover can be cost and insurance paid or cost insurance and freight. Since your bank is a mediator, they will expect your exporter or seller to provide documents related to their insurance coverage. They will review these documents in line with the letter of credit. Upon verification, they gain evidence that the exporter covers the damage costs and can release payment knowing their investment is covered.

Types of letters of credit:

Letter of credit can be classified as:

- Clean L/C
- Revocable L/C

- Irrevocable L/C
- Confirmed L/C
- Transferable L/C
- Red clause L/C

Clean L/C:

- It refers to the letter of credit stipulates that the beneficiary need only draw a sight draft under the letter of credit and present it in bank to obtain funds and that no other document need be presented.

Revocable L/C:

- A revocable L/C can be cancelled or amended at any time before payment. It is intended to serve as a means of arranging payment, but not as a guarantee of payment.

Irrevocable L/C:

- An irrevocable L/C obligates the issuing bank to honour drafts drawn in compliance with the credit and can neither be cancelled nor modified without the consent of all concerned parties.

Confirmed L/C:

- A confirmed letter of credit gives the exporter a double guarantee of payment, one from the issuing bank and one from the advisory bank.
- Under a confirmed letter of credit, the advisory bank agrees to pay the exporter for the goods, even if the issuing bank ultimately fails to honour its obligations.

Transferable L/C:

- A transferable letter of credit is a letter of credit that allows the first beneficiary to transfer some or all of the credit to another party, creating a secondary beneficiary.

Red clause L/C:

- Red clause letters of credit include a special clause that allow the seller to receive partial payment in advance of shipment.
- This advance payment, often referred to as a "red clause advance," can be used by the seller to finance the production or purchase of goods for export.

2.Draft:

- The draft, also called the bill of exchange, is written by an exporter on the importer directing the latter to pay a certain sum on a specified date for having goods shipped to the importer. The exporter submits the bill to its banker who collects the stated amount from the importer's bank and remits the proceeds to the seller or to the bearer.
- The draft has three parties. The exporter-is the party who draws the bill and hence called the drawer, the importer on whom the bill is drawn and hence called the drawee, and the party who is entitled to receive payment is called the payee. Normally, the drawer and the payee are the same persons in which case there are only two parties to a draft.
- The draft serves three important functions and hence is widely used in foreign trade:

1. It provides written evidence of obligations in a comprehensive form.

2. It enables both parties to potentially reduce their costs of financing.

3. It is a negotiable and unconditional instrument.

- To serve the three purposes, the draft needs to fulfill the following conditions:
    - It must be in writing

- Signed by the drawer (exporter)
- An unconditional order to pay
- A certain sum of money
- Payable on demand or on a specified future date
- Payable to order or bearer

3.Bill of lading:

- The most important document used in financing of foreign trade is the bill of lading (B/L). A B/L is a shipping document issued to the exporter or its bank by a common carrier that ships the goods. It serves three important functions:

1. It is a receipt acknowledging that the goods have been received by the carrier.

2. It is a contract binding the carrier to deliver the goods to the importer.

3. The negotiable B/L, its most common form, is a document that establishes control over the goods.

- A bill of lading can be either a straight or order B/L A straight B/L consigns the goods to a specific party, normally the importer, and is not negotiable. A straight B/L is used where no financing is involved. As the straight bill is not negotiable, this is not popularly used in export financing.
- What is mostly used is the order B/L. Under an order B/L, the goods are consigned to the order of a named party, usually the importer. The exporter retains title to the goods until it endorses the B/L on the reverse side. The exporter's representative may endorse to a specific party or endorse it in blank by simply signing his or her name. The carrier delivers the goods in the port of destination to the bearer of the endorsed order B/L who must surrender it.
- As an order B/L represents goods in transit that are readily marketable and fully insured, this document is generally considered to be good collateral by banks. It is required under letter of credit financing and for discounting of drafts.

19.0 Exchange rate risk Management

Foreign exchange risk

Foreign exchange risk also known as currency risk, FX risk, and exchange rate risk. It refers to the losses that an international financial transaction may incur due to currency fluctuations. It arises from the change in the price of one currency in relation to another.

Foreign exchange risk arises when a company engages in financial transactions denominated in a currency other than home country currency. Any appreciation/ depreciation of the base currency or the appreciation/ depreciation of denominated currency will affect the cash flow emanating from that transaction.

Exchange rate exposure

The gain or loss arising on account of unanticipated exchange rate charges is known as exchange rate exposure.

The purpose of exchange rate risk management is to minimise/eliminate the loss accruing on account of exchange rate changes.

Exchange rate exposure can be classified as

- Translation exposure
- Transaction exposure
- Real operating exposure

Translation exposure

Translation exposure refers to exchange rate risk arising out of the transaction of the functional currency into the reporting currency.

Were

(Reporting currency: the currency in which one entity's financial statements or other financial documents are reported) (functional currency: currency used by a business or unit of business)

- Translation exposure also known as accounting exposure that does not involve cash flow.
- It consolidated the financial statements of different units of multinational firm for the purpose of ascertaining overall profitability and evolution of comparative performance of different subsidiaries.
- When the currency of any host countries changes its value, it translates value in the domestic currency of the parent company (Home country currency)
- The larger the fluctuation in the value of host country currency, the greater the size of accounting exposure

Transaction exposure

Transaction exposure refers to the changes in the exchange rate causing changes in the present cash flow.

It occurs on account of

1. Expert and import of commodities on open account.
2. Borrowing and lending in the foreign currency or
3. Intra firm flows

1. If a firm has to make payments for imports in a foreign currency and the foreign currency appreciates the firm will have to incur losses in terms of its own currency.
   1.1. Similarly, if an exporter has to receive foreign currency for its export and the foreign currency depreciates, the exporter will have to face loss in terms of its own currency.
2. The borrower of foreign currency is put to loss if that particular foreign currency appreciates. Changes in exchange rate alters the value of intrafirm cashflow.

Example:- If the Indian subsidiary of a US company repatriating dividend to the parent company, any depreciation in rupee will lower the value of dividend to be received by parent company in dollar terms.

But if the Indian subsidiary export goods to its parent company, company invoiced in rupee, in the parent company will have to pay lesser amount in terms of dollars for this transaction due to rupee's depreciation.

Real operating Exposure

Real operating exposure refers to the changes in the exchange rates together with the rates of inflation that cause change in the future cashflow.

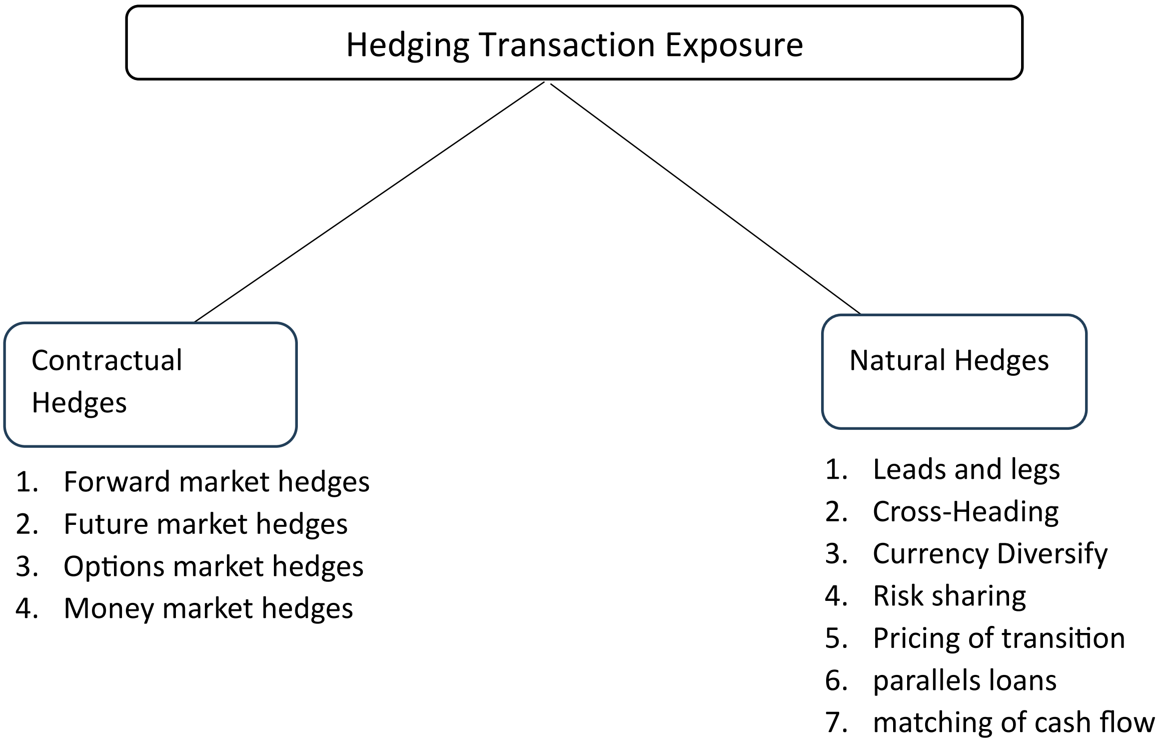
The word 'real' denotes the concept of real exchange rate adjusted for inflation. The word 'Operating' is used because it considers the operating cash flow, a change which cause change in the value of the firm.

Management of Exchange rate exposure

Transaction Exposure

Hedging refers to minimising the exchange rate risk through buying and selling of currency in the foreign exchange market or in the markets for derivative.

(Hedging Transaction exposure)



1. **Contractual hedge**
    - Forward market hedge
    - Future market hedge
    - Option market hedge
    - Money market hedge
2. **Natural hedges**
    - Leads and lags
    - Cross hedging
    - Currency diversification
    - Risk sharing
    - Pricing of transactions
    - Parallels of loans
    - Matching of cash flows

Contractual hedge

Contractual hedge is a contractual arrangement between two parties to buy or sell an asset at a predetermined price in the future.

Forward Market hedge

In the forward market is the exporter sales forward, and the importer buys forward, the foreign currency in which the trade is so involved.

Example: - Suppose an Indian exporter signs a contract for leather export to USA for US $1,000. The export proceeds are to be received within 3 months. The exporter fears a drop in the value of the US dollar. Who is made diminish the export earnings. To avoid this diminution, The exporter goes for a 3-month forward contract and sale US $1,000 forward. The sport as well as the forward rate is Rs. 40/ US $. If the dollar depreciates two Rs. 39 after 3 months the export earnings in the absence of any forward contract would have diminished to Rs.39,000, but since the exporter has already sold the forward a similar amount of dollars the loss occurred due to depreciation of the dollar will be made through the forward contract. Selling the dollars on maturity would fetch him Rs. 40,000 which will be equal to the original export value.

Future market hedge

In the future market hedge, futures are contracts that can specify a price at which a currency can be bought or sold at a future date.

The only difference is that in case of forward contracts the deal is settled on maturity, but in case of currency futures the rates are matched every day with the movements in the spot rates and on this basis gains and losses are settled every day. This process is called 'marking to the market'

Option market hedge

For hedging in the currency options market, the importer buys a call option or sales a put option or performs both the functions at the same time. The exporter buys a put option and sells a call option or performs both functions simultaneously.

Money market hedge

Money market is just taking a money market position to cover future payables or receivables position and importer who is to cover future payables,

I. Firstly borrows local currency

II. Secondly converts the borrowed local currency into the currency of payables and III. Finally invest the converted amount for a period matching with the payments to be made for imports. on the contrary, an exporter hedging receivables firstly borrows the currency in which the receivables are denominated secondly converts the borrowed currency into local currency and finally invest the converted amount for a maturity coinciding with the receipt of export proceeds.

Example: - suppose an Indian importer has to make payments for imports Earth US $1000 after 90 days. The importer has to create in 90 days investment in the foreign currency in which the import is invoiced. The amount of initial investment will be such that the principal plus interest after 90 days equals the payment for import. If the rate of interest on investment is 12% per annum and if the amount of import US $1000 the sum of initial investment will be US $ 1000/1.03 = US $970.87

On the day imports will be paid, the importer will receive US $1000 from investment and there will be no problem even if the exchange rate changes.

Natural hedge

Firms go for natural hedges because contractual hedge provides only temporary protection against exchange rate movement and sometimes the market for contractual hedge is not well developed. Some important natural hedge techniques are

Leads and lags

Lead means accelerating or advancing the timing of receipt or payment of foreign currency. Lag is just the reverse, which means decelerating or postponing the timing of receipt or payment of foreign currency.

Cross hedging

Cross hedging refers to hedging in some other currency correlated with the desired one. In this case the farm has to identify a foreign currency that can be hedged, the volatility of which is highly correlated with that of the desired currency.

Currency diversification

If transactions are diversified over a number of currencies and if there is negative correlation in the change of their values, the exchange rate risk is automatically minimized. The greater the diversification, the lesser the risk.

Risk sharing

Risk sharing is a contractual arrangement through which the buyer and the seller agree to share the exposure.

Pricing of transactions

Pricing policies adopted in two ways. One is price Variation and other is currency of invoicing. Price variation involves marking up or marking down of sale price in order to counter the adverse effects of exchange rate changes.

In the currency of invoicing, the exporter is willing to invoice the bill in its own currency or in the currency in which it incurs the cost so that the transaction exposure is avoided. But if the importer is dominant the bill is normally invoiced in the importer's currency.

Parallel loans

Parallel loan is also known as back-to-back loan or credit swap loan. Parallel loan is the simultaneous borrowings and lending involving four parties in two countries.

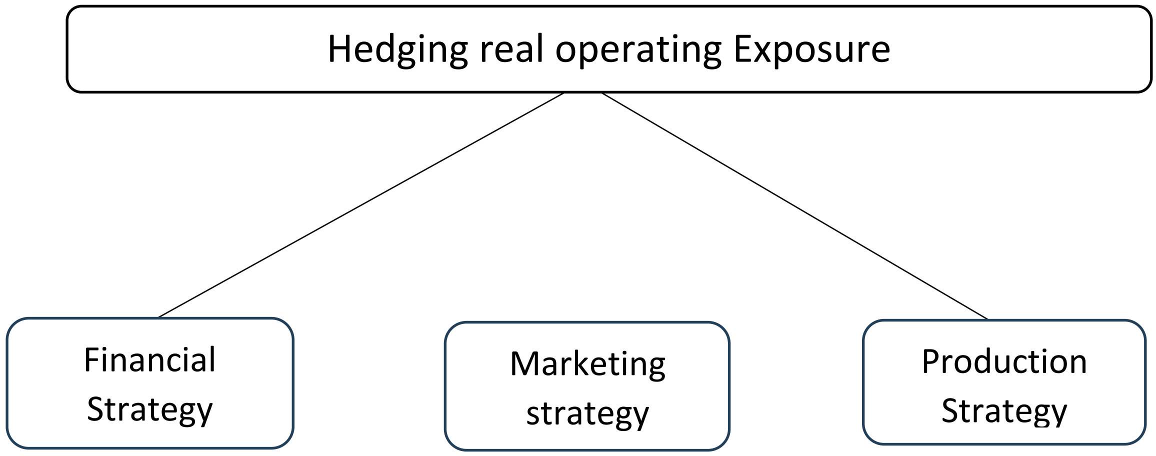
Example: - suppose a US company (parent company) has a subsidiary in India. At the same time an Indian company (Parent company) has a subsidiary in United States of America. Suppose further that the US parent company has to l3nd US $1,000 to its subsidiary in India for a specific period. The Indian parent company too has to lend a similar amount for the same in maturity to its subsidiary in United States of America. If the funds move between the two countries and if the exchange rate changes, transaction exposure will be caused. Thus, in order to avoid the exposure, the Indian parent company will lend the above amount converted into the rupee at the spot exchange rate to US subsidiary. Simultaneously the US parent company will lend a similar amount in terms of US dollar to the Indian subsidiary. At the expiry of the specific period the two loans will be repaid to the respective lenders.

Messing of cash flows

Under this mechanism, a firm matches its foreign currency inflow with the outflow in that currency not only in respect of size but also in respect of timing. But for this purpose, it is necessary that the firm has both inflows and outflows in the same currency.

Hedging of real operating exposure

The management of real operating exposure includes strategy concerning finance production and marketing.



Financial strategy

While developing a financial strategy, the finance manager has to ensure that the firms liability during the application of marketing and production strategies are so structured that they could match a reduction in assets' earning during that period.

Marketing strategy

The marketing strategy includes among other things selection of market, product planning and pricing policy. If the domestic currency appreciates export would turn uncompetitive on account of price. The strategy in this case should be to pull out of the existing market and to develop new markets.

Production strategy

Production strategy concentrate primarily on product sources, input mixing and plant location. If the currency of a country supplying inputs appreciates, the input buying firms has to find out some other sources of supply that may be cheaper. If the home currency appreciates, it would be in the interest of the input buying firm not to change the source of supply and preferably buy inputs from countries to which it export its final product.

Managing translation exposure

There is no need for hedging translation exposure as it does not affect the cash flow. But firms try to hedge it in view of its potential impact on the reported consolidated earnings.

The commonly used technique with respect to hedging of translation exposure is known as the balance sheet hedge. Since translation exposure arises out of mismatch between the size of assets and the size of liabilities resulting from the conversion of figures in the functional currency to those in the reporting currency using different methods of conversion. If the liabilities are lower than the assets, fresh borrowings are made in weaker currencies and If liabilities exceeds assets, fresh investments are made in stronger currencies.

20.0 Global Human Resource Management

Global human resource management is the discipline of taking care of workforces in a public or private company, for organisations that operate in more than one country or continent. Global HR is how international employers manage geographic, linguistic and cultural differences amongst their workforce to achieve maximum productivity and engagement. It means supporting, managing and engaging employees around the world, deploying common policies but also taking into account local legislation, customs and culture. Its primary responsibilities include:

- Recruiting suitably skilled employees
- Supporting regulatory compliance
- Standardizing processes and systems
- Analysing metrics between markets

Challenges Faced By Expansion And Global HR:-

Global HR challenges are an inevitable part of expansion and if not properly managed, can hinder a company’s ability to achieve its international ambitions. Leaders at outward-looking companies need to equip themselves with capabilities to address the following difficulties:

- **Finding the right employees** :-

Recruiting people with the right vision, skills and adaptability can be demanding, especially when specific technical skills are required. The supply of qualified professionals may also be diminished in certain countries with low unemployment rates.

- **Managing scale**

As companies increase in size and span a wider range of cultures, managing an international workforce becomes that much more complex. Mergers and acquisitions further exacerbate the problem because in addition to the communication challenges posed by different languages, change naturally gives rise to uncertainty among employees.

- **Keeping employees engaged :-**

Engagement and employee performance are usually influenced by improvements in working conditions. Therefore, a company must treat employees in new divisions just as well as it does in its established markets.

HOW TO SUCEED IN GLOBAL HR :-

- **Ensure leaders have the proper background**:-

Companies must appreciate that specific skills and experience are required for international expansion. Executives who have built their careers managing domestic operations may not be best equipped to lead global HR.

- **Assert the strategic role of HR**:-

Human Resources is not always well represented on boards of directors, but they may need to raise their voices. The more assertive their recommendations – whether it's identifying who is best capable to lead expansion efforts.

- **Use data insights effectively:-**

Many businesses have successfully applied analytics to drive global HR operations, including, payroll and recruitment. Data analysis also enables managers to identify and share best practices so they can improve processes throughout their organization.

- **Let technology guide integration:-**

Of all the tactics, integrating HR systems, workflows and data across geographies can have the most positive impact on global expansion. The key is to adapt processes to technology and not the other way around.

- **Build a culture of diversity:-**

If a company's culture is built on diversity and inclusion and is focused on attracting and retaining local talent, it will be better prepared for international expansion. Balancing the efficiency afforded by centralization with respect for cultural differences further increases the chances of success.

Strategies to Ensure Effective Global HR Management

Effective global human resource management (HRM) is:

1. Establish Clear Communication Channels:

First and foremost, global human resources managers must create channels that allow for regular updates, feedback, and collaboration. For that, you must explore different communication tools– from video conferencing to instant messaging to offline communication.

2. Develop a Global HR Strategy:

To manage a diverse workforce, create policies and procedures that align with local laws, cultural differences, and market trends. A comprehensive global HR strategy ensures fairness across all locations.

3. Invest in Cross-Cultural Training:

As we all know, different cultures have different ways of communicating and working. For this reason, provide training that enables employees to work together and understand each other’s perspectives.

4. Ensure Legal Compliance:

Likewise, labor laws and regulations vary across countries. For the same reason, you must stay up-to-date on local laws and ensure HR policies align with these requirements. Get legal advice to ensure compliance.

5. Foster a Positive Workplace Culture:

There is no doubt that a positive workplace culture promotes employee engagement and satisfaction. As an HR, it should be your responsibility to encourage teamwork, diversity, and inclusion. Also, recognize and reward employee achievements.

6. Leverage Modern Technology:

When it comes to global human resource management, technology can certainly be your best buddy in helping you simplify HR management. Use HRIS, virtual training, and other digital tools that enable communication.

7. Offer Competitive Compensation and Benefits:

When you are working in a global landscape or marketplace, you must offer competitive compensation and benefits packages. Research local market conditions to ensure that your salaries and compensation packages are attractive.

8. Continuously Evaluate and Adapt:

Lastly, HR management requires ongoing evaluation and adaptation. Global HR managers must regularly seek employee feedback and adjust policies as and when needed. Instead of being inflexible, remain agile to respond to changes in the market.

Expatriate manager:

An expatriate manager, also known as an international manager, is an executive who leads international assignments across cultures and countries. They manage overseas subsidiaries, alliances, and international joint ventures (IJVs). Expatriates are employees who live in a country other than their own for a short or long-term work assignment. Expatriate managers are important for the success of multinational enterprises' (MNEs') international operations. They can bring their local office culture and processes to new locations, which helps ensure workplace consistency across markets. They also offer a deeper understanding of business, which is important when establishing a new office in a new country.

In the Indian HR context, expatriates are often senior managers or specialists sent by multinational companies to oversee operations in India or Indians sent by Indian multinational companies to other countries.

Why do companies use expatriate employees?

Companies use expatriate employees as part of their global expansion strategy to reap benefits such as business consistency, expertise continuity, and overcoming talent shortages. We discuss the advantages of using expats below.

When selecting expatriate managers for international business, organizations consider factors such as technical skills, soft skills, cross-culture abilities, emotional stability, Open-mindedness, willingness to change, Interpersonal skills.

Advantages of Being an Expatriate Professional:

1. Global Perspective and Cultural Immersion:

Working as an expatriate professional provides a unique opportunity to gain a global perspective and immerse oneself in a new culture. By living and working abroad, professionals can develop a deeper understanding of different customs, traditions, and work environments, fostering cultural intelligence and adaptability.

2. Enhanced Professional Development:

Expatriation offers a platform for accelerated professional growth. Professionals can expand their skill sets, learn new industry practices, and develop cross-cultural communication abilities. The exposure to diverse business practices and work methodologies contributes to a well-rounded professional profile, making expatriate professionals highly sought after in the global job market.

3. Expanded Global Network:

Being an expatriate professional enables individuals to establish a broad network of contacts from around the world. Building relationships with professionals from diverse backgrounds not only facilitates knowledge sharing but also creates potential business opportunities and collaborations across international boundaries.

Challenges of using expatriate employees

High costs:

Relocating talent or hiring expatriates as part of your global expansion strategy typically comes with higher costs than hiring local employees in a new country.

Tax equalization:

In addition to comparatively higher salaries and expat employee benefits, most companies use tax equalization to ensure that both their local and expat employees have the same tax burden.

Tax equalization programs ensure that employees who are sent to work in foreign countries don't experience significant tax-related disadvantages due to their international assignment.

Ongoing wellness support:

Expatriate employees who relocate abroad face stressors they wouldn't normally need to manage in their home country. From learning a new language to navigating new cultural norms, the relocation process is lengthy and challenging.

IMPORTANT QUESTIONS

1. **Following are short question of 2 marks each**

a. Turnkey projects

b. Inward approach
c. Outward approach
d. Expatriate Manager
e. FII
f. Brown field investment
g. Green field investment
h. Leontiff Paradox
i. Rules related to aliens
j. Ethnocentric policy
k. Tariffs
l. Quota and types of quota
m. VER (Voluntary export restraints)
n. Balance of payment
o. dumping
p. transfer pricing

q. bill of lading
r. GATS
s. TRIPS
t. United nation conference of trade and development (UNCTAD)
u. Preferential trade area (PTA)
v. Totalitarianism
w. Intellectual property (IPR)
x. doctrine of comity
y. Hofstede's study
z. MFN
a. Embargo
b. Counterfeiting
c. countervailing duty
d. rule of origin

2**. Following are 6 marks questions**

a. Absolute advantage and comparative advantage
b. Product life cycle theory
c. Hecksher Ohlin theory
d. MTN (Multi-lateral trade negotiation)
e. Regional trade block
f. standardisation vs differentiation
g. Make or buy decision in case of sourcing of input
h. Letter of credit
i. Exchange rate exposure
j. difference between domestic and international business
k. Globalisation and factors causing globalisation
l. Differentiate between domestic and international business
m. Standardisation VS Adaptation
n. Counter Trade theories
o. Uruguay round of discussion
p. European Union
q. SAARC
r. Porter's diamond
s. What are the sources of inputs in international business? Explain make or buy decision.
t. Explain letter of credit. Elaborate different types of letter of credit
u. Exchange rate risk and its management

3. Different modes of entry into international business (16 marks)
4. What is FDI? Explain the factors influencing FDI (16 marks)
    a. Theories of FDI
6. Role and function of WTO and GATT (16 marks)

7. What are the different approaches to strategy formulation? Explain its broad spectrum (16)

8. Explain environmental scanning in international business. Write political risks associated with international business environment (16)
9. Describe different types of tariff and non-tariff trade barriers in international business. (16)
10. Design an international organisation structure for effective international business (16)