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BACHELOR OF COMMERCE

BCOM 306

INTERNATIONAL BUSINESS

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STRUCTURE

1.0 LEARNING OBJECTIVES

International business covers movement of goods or services as well as business transactions among individuals, parties, companies or corporate entities in private or public sector occurring across national boundaries. The objective of this chapter is to get the students acquainted with the basic concept, evolution, activities, and reasons of International Business, difference between International Business and Domestic Business and the growing relevance of globalisation.

After reading this chapter, students will be able to:

- Describe the concept of International Business
- Explain different types International Orientations (EPRG Framework)
- Importance of studying International Business
- Understand the reasons to go global

1.1 INTRODUCTION TO INTERNATIONAL BUSINESS

Every day we purchase products like clothes, tea, drinks, perfume, car accessories, electronic items, mobile phones etc. We used to purchase products through online or offline. This process of purchase gives us the prospect of transacting in the international business arena without visiting or knowing the various countries and sometimes companies across the globe. We get all these products even without visiting or knowing the country of origin and even sometimes don't know where products are developed, designed or manufactured. All these activities have become a reality due to the operations and activities of international business. Thus, international business is the process of fulfilling the objectives of the organizations by utilising the resources available in any part of the globe and converting global business threats into business opportunities.

International business covers movement of goods or services across national borders. Thus, International business may be defined simply as business transactions that take place across national borders. Any business transaction between parties from more than one country is a part of international business. The buying and selling of goods, services, technology, capital or knowledge across the national boundaries of a country are known as international business.

1.2 EVOLUTION OF INTERNATIONAL BUSINESS

The post-World War II era observed a phenomenon expansion of local business into international. The post 1990 period the international business was expanded by multinational companies. The concept of international business has emerged from the concept of 'international marketing', which in turn, emerged from the concept of 'export marketing'. Initially, the companies started export to nearby places or countries, then later on to export far away countries. In addition to export, the companies started marketing efforts in global markets to boost demand of their products. It is the phase of change of international trade into international marketing. Later on, the companies started locating their plants in foreign markets, designing products and started production in global markets. Further, the companies started producing in one foreign market and from their marketing in another foreign market. It is the phase of change of international marketing into international business. All the phases are elaborated in the following stages:

Stage 1: Domestic-market establishments

The domestic market is a home market where new products could be developed, tested and fine-tuned performance before tackling the complexities of international trade. It can also give a good indication of performance with the local target market.

Stage 2: Export-division establishments

After having a strong foundation in domestic market, the companies start exporting, since it is a relatively low cost option (at least compared to building factories abroad). Export may be handled by a department with an export manager and a few staff members. This department deals with various activities of exporting, such as export research and planning, product representation, exhibitions, advertising, forex management, shipping and export-import procedure & documents, etc., and related issues.

Stage 3: International-division establishments

With the growth of the businesses, information flow from overseas markets increases at very high level. The export executives may involve providing overseas customers more information in the way of sales, marketing, service support, etc. Now, the companies establish offices and recruiting staff members in overseas markets. Often companies feel that opening their own sales or service offices overseas is a good way to handle the operations and information flows. Opening overseas offices with manpower is very expensive; however, the companies are having more control on overseas business operations.

Stage 4: International marketing establishments

After international-division establishments, the companies start establishing subsidiaries in overseas markets for setting up the manufacture or assembly of their products in markets abroad. The role of the headquarters increases guiding and overseeing its more sophisticated business operations abroad. In international marketing, efforts are make to better tap the requirements/needs of the overseas targeted customers.

Stage 5: International business establishments

As the businesses expand into overseas markets, the companies develop the subsidiaries abroad to handle the businesses. In subsidiaries, the headquarters may not have a centralised decision-making and most of the operations regarding the operations in the overseas markets may be run by local executives in foreign markets. Now, the companies are multinational companies. The multinational companies are having control on a wide variety of operational issues in foreign subsidiaries.

Eventually, some firms evolve to the point where they pay little or no attention to borders or geography, at this stage the multinational companies become transnational companies. They invest, source quality raw materials, build their products or perform R&D anywhere in the world, if it helps maximize their performance and profitability.

Any type of business transaction between the headquarters and subsidiaries of the multinational companies or translational companies is a part of international business.

1.3 ACTIVITIES COVERED UNDER INTERNATIONAL BUSINESS

International business covers movement of goods or services as well as business transactions among individuals, parties, companies or corporate entities in private or public sector occurring across national boundaries. Any business transaction between parties from more than one country is a part of international business. The business activities beyond national boundaries include the transactions of economic resources such as goods, capital, knowledge, services, technology, skilled labour, logistics, and transportation and production activities.

Thus, international business includes not only international trade of goods and services but also foreign investment, especially Foreign Direct Investment (FDI). It also includes various activities related to production of goods and services like insurance, banking, consultancy, construction, turnkey projects, finance etc. International Business includes the following activities:

- International business comprises all business related transactions (private and governmental, marketing, sales, finance, investments, logistics, supply chain management and transportation) that take place between two or more companies, or countries. These commercial activities transactions take place across political boundaries.

- It refers to all those business activities which involve cross border transactions of goods, services, resources between two or more nations. Transaction of economic resources include man, material, money, machine, skills, etc. for international production of physical goods and services such as finance, banking, insurance, construction etc.
- The business activities can take any of the form like import, export of different goods or services, the investment of capital, and transactions in intangible assets (e.g. trademarks, copyrights, patents, licensing and franchising rights, licensing of manufacturing technology etc).

1.3.1 REASONS FOR COMPANIES TO ENGAGE IN INTERNATIONAL BUSINESS

In today‘s global economy, companies of all sizes are establishing operations in foreign markets and engage in international business for several reasons. This reason may be expansion which can provide several advantages, including greater opportunities for market growth, or diversification. Some companies acquire other firms in foreign countries. Acquisition provides full control over foreign business and quick establishment in foreign market share. But it requires heavy investment and the risk is more. More and more foreign countries are becoming a source of both production and sales for many firms. New operations in foreign markets give the chances to produce more and sell more products in the other countries. Some of reasons for the companies for engaging international business are discussed below:

To Expand Sales

The first and foremost reason is that the multinational companies would like to expand their sales and acquire newer markets so that they can record impressive growth rates. This is the main purpose of engaging in international business. Companies invest in foreign trade and import-export business for earning a profit. Considering the fact that the consumers are having different tastes, preferences, choices, caste, colour, creed, habits, culture, behaviour, attitude & lifestyles, but the companies would like to target need and hence, expand into these markets. Moreover, some companies with declining sales in one region may target different markets abroad in hope to recoup the losses by expanding into other markets. Further, the attractive rates of return in the emerging markets are another reason as well.

To Acquire Resources

Multinational companies require resources for continuing their businesses. They have to acquire this resource across the boundaries. This is one of the most important reasons for multinational companies which are helpful for them to expand internationally. The developing and emerging countries have valuable resources like manpower (skilled as well as unskilled), materials like large deposits of minerals, metals, chemicals, ores and land for agricultural production, money and machine. So, the multinationals companies eye these markets in order to get access to these valuable resources. This is the reason of presence of multinational corporations in South Asian Countries where the huge deposits of minerals, metals, ores are easily available and at very low cost. Most importantly, labor in developing countries is much cheaper when compared to developed countries and labor cost has a direct impact on the cost of production which affects the margins of multinational companies. In this way multinationals companies can make profits.

There is one more reason of the presence of multinational companies in developing and emerging countries. These countries do not have the expertise or the resources needed to tap their reserves of these valuable minerals and metals. Hence, the governments welcome the multinationals into their countries. The keenness to tap the resources available in these countries is one of the most important reasons for expansion.

To Minimize Risk

Often, businesses expand internationally to offset the risk of stagnating growth in their home country as well as in other countries where they are operating. In the time of negative growth or slowdown the multinational companies from developed countries have made a beeline to the developing countries. Companies seek foreign markets to minimize swings in sales and profits arising of business cycle i.e. recession and expansions, which occur differently in different countries. Since firms exist to make profits and grow their bottom lines, it is but natural for them to expand internationally into countries that have better growth rates than their home country. Further, by functioning in many countries, they are able to manage political, economic, and societal risks better. Because they vary from country to country, it makes sense to spread risk across countries and diversify the portfolio. Some companies look to international countries for lower-cost manufacturing, technology assistance and other services in order to have competitive edge.

1.3.2 RISKS IN INTERNATIONAL BUSINESS

- Strategic risk
- Operational risk
- Political risk
- Technological Risk
- Environmental Risk
- Economic Risk
- Financial risk
- Terrorism Risk
- Planning risk
- Currency risk

1.3.3 IMPORTANCE OF STUDYING INTERNATIONAL BUSINESS

- In today‘s scenario, maximum of the companies are either international or compete with international companies;
- Exploring basic concepts underlying international finance, management, marketing, and trade relations;
- The interrelatedness of one country's political policies and economic practices on another countries;
- Modes of operations may differ from those used domestically;
- Identifying forms of business ownership and international business opportunities;
- Learning to improve international business relations through appropriate communication strategies; and
- Understanding the global business environment in the form of interconnectedness of cultural,

political, legal, economic, social and ethical systems.

1.4 CHECK YOUR PROGRESS

1. International business transactions include:

(A) Sales (B) Investments

(C) Transportation (D) All of the Above

2. Which of the following takes place when a company exports goods and services to buyers/importers in another country?

(A) International Trade (B) International Investment

(C) International Technology (D) International Production

3. Which of the following statements not related to polycentric firms?

(A) Compatible with host country market oriented policy.

(B) Compatible with home country market oriented policy.

(C) Marketing strategy is localization.

(D) A high degree of autonomy in decision-making to subsidiary heads.

4. When the values and priorities of the parent organization guides the strategic decision making of all its international operations, it is known as

(A) Polycentric Orientation (B) Regiocentric Orientation

(C) Ethnocentric Orientation (D) Geocentric Orientation

5. Globalization means:

(A) Cross-border movement of goods only

(B) Cross-border movement of goods and services both

(C) Cross-border movement of goods, services, capital

(D) Cross-border movement of goods, services, capital, information and people

6. All commercial transactions between two or more countries are known as:

(A) Foreign Trade (B) International Business

(C) Balance of Payments (D) Globalization

7. Extension marketing strategy is used in which of the following orientation?

(A) Polycentric approach (B) Regiocentric approach

(C) Ethnocentric approach (D) Geocentric approach

State whether the following statements are True or False:

8. For geocentric firms the entire world is a single market and key management positions are filled by merit regardless of nationality of people.

9. Ethnocentric firms are compatible with host country market oriented policy.

10. Polycentric firms have a high degree of autonomy in decision-making to subsidiary heads.

11. A core element of globalisation is the expansion of world trade through the elimination or reduction of trade barriers, such as import tariffs.

12. Import controls can create problems for an international marketer.

13. These are the stages of internationalization of business: Domestic Company → International Company → Multinational Company → Global Company → Transnational Company

Fill in the blanks

14. EPRG framework was introduced by Wind, Douglas and H V Perlmutter in___________.

15. _______________is defined as the tendency of a firm to be largely concerned with its viability and legitimacy only in its home country.

1.5 SUMMARY

International business is the process of fulfilling the objectives of the organizations by utilising the resources available in any part of the globe and converting global business threats into business opportunities. The concept of international business has emerged from the concept of _international marketing‘, which in turn, emerged from the concept of _export marketing‘. Initially, the companies started export to nearby places or countries, then later on to export far away countries. In addition to export, the companies started marketing efforts in global markets to boost demand of their products.

It is the phase of change of international trade into international marketing. Later on, the companies started locating their plants in foreign markets, designing products and started production in global markets. Further, the companies started producing in one foreign market and from their marketing in another foreign market. It is the phase of change of international marketing into international business.

International business covers movement of goods or services as well as business transactions among individuals, parties, companies or corporate entities in private or public sector occurring across national boundaries. Any business transaction between parties from more than one country is a part of international business. The business activities beyond national boundaries include the transactions of economic resources such as goods, capital, knowledge, services, technology, skilled labour, logistics, transportation and production activities.

Thus, international business includes not only international trade of goods and services but also foreign investment, especially foreign direct investment (FDI). It also includes various activities related to production of goods and services like insurance, banking, consultancy, construction, turnkey projects, finance etc. International Business includes the following activities: International business comprises all business related transactions (private and governmental, marketing, sales, finance, investments, logistics, supply chain management and transportation) that take place between two or more companies, or countries. These commercial activities transactions take place across political boundaries. It refers to all those business activities which involve cross border transactions of goods, services, resources between two or more nations. Transaction of economic resources include man, material, money, machine, skills, etc. for international production of physical goods and services such as finance, banking, insurance, construction etc. The business activities can take any of the form like import, export of different goods or services, the investment of capital, and transactions in intangible assets (e.g. trademarks, copyrights, patents, licensing and franchising rights, licensing of manufacturing technology etc).

Some of reasons for the companies for engaging international business are: To Expand Sales, To Acquire Resources, To Minimize Risk.

The domestic companies are facing very difficult business environment as the in international business the companies have to face varying environmental factors like political, legal, economic, socio-cultural and ethical in host countries, often not known to the firm. The big multinational companies are getting benefit of intra-firm transactions using transfer pricing, which is a common practice. The companies are facing the presence of political risk and also of exchange rate risk, sometimes leading to financial risk in host countries. They have to opt varying strategies of business in different host countries as well.

Globalisation is the process of interaction and integration among people, companies, and governments globally. The relevance of globalisation is increasing because of following reasons: Firms need global orientation even to survive in the domestic market. Domestic consumption of foreign goods is rising fast. Production process, communication, advertising and marketing are increasingly becoming global.

There has been growth in globalization in recent decades due to the following factors: Internet, Technology, Governments, Services, lower costs of ocean shipping due to containerisation, bulk shipping, Consumers‘ interest, Competition, Foreign exchange controls, Political relationships, Countries cooperate more on transnational issues, Global businesses and brands, Cross-national cooperation and regional agreements.

EPRG stands for Ethnocentric, Polycentric, Regiocentric, and Geocentric. Ethnocentric Firms: are those that adopt home market oriented policy and seldom distinguish between domestic operation and global operation policies. Polycentric Firms: follow a host market oriented policy. Regiocentric Firms: Region becomes the relevant geographic unit (rather than by country). Geocentric Firms: maintains a balance between the home market and host market oriented policy.

Risks in International Business are: Strategic risk, Operational risk, Political risk, Technological Risk, Environmental Risk, Economic Risk, Financial risk, Terrorism Risk, Planning risk, and Currency risk.

1.6 KEYWORDS

International Business : International business may be defined as those business transactions among individuals, firms or corporate entities in private or public sector that result in movement of goods or services across national boundaries.

International Trade: International trade is a term that basically deals with the movement of goods and services between countries distinct from normal corporate transactions involving buyers and sellers in different countries. The international trade primarily reflects macro or aggregate supplies and demand in different countries. The global trade, thus, involves major policy decisions by governments of nations with regards to imports and exports as also national economic development.

International Marketing: It focuses on the firm-level practices across the border including marketing identification and targeting, entry mode selection, marketing mix and strategic decisions to compete in the international markets.

Global Marketing: Global marketing treats the whole world as a single market and standardizes the marketing mix of the companies as far as feasible. A global company does not differentiate between the home country and foreign country and considers itself a corporate citizen of the world.

Multinational Corporation (MNC): An MNC is an enterprise with a substantial part of its operations in a number of foreign countries. It is also called transnational corporation or supranational corporation. It is an enterprise that owns or controls production or service facilities outside the country in which it is based. It must generate sizeable proportion of its revenue from foreign operations, big enough to have many foreign branches and subsidiaries. According to Vernon and Wells Jr., ―MNC represent a cluster of affiliated firms located in different countries that: MNCs are linked through common ownership, MNCs draw upon a common pool of resources, MNCs respond to a common strategy.

Global Company: Global companies serve world markets from a single country and tend to retain association with a headquarters country.

Transnational Company: Transnational companies serve global markets and acquire resources globally; blurring of national identity.

Ethnocentric Firms: Ethnocentric firms are those that adopt home market oriented policy and seldom distinguish between domestic operation and global operation policies.

Polycentric Firms: Polycentric firms follow a host market oriented policy.

Regiocentric Firms: Region becomes the relevant geographic unit (rather than by country).

Geocentric Firms: Geocentric firms maintains a balance between the home market and host market oriented policy.

1.7 SELF- ASSESSMENT TEST

Q.1 Explain the meaning of international business.

Q.2 What are the reasons to consider international business?

Q.3 What are the main strategies of international business?

Q.4 Define international business and discuss the scope of international business.

Q.5 Differentiate between domestic and international business.

Q.6 Elaborate the risks and issues in global business.

Q.7 Describe the objectives of international business.

Q. 8 Write short note on:

a) Polycentrism

b) Ethnocentrism

c) Regiocentrisn

d) Cultural Shock

e) Geocentrism

Q.9 Trace out the growth of International Business from 1991 till date.

Q.10 Explain the importance of international business with reference to India.

1.8 ANSWERS TO CHECK YOUR PROGRESS

(1) D	(2) A
(3) B	(4) C
(5) D	(6) B
(7) C	(8) True
(9) False	(10) True
(11) True	(12) True

(13) True (14) 1969

(15) Ethnocentric

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Globalisation

STRUCTURE

2.0 LEARNING OBJECTIVES

After reading this chapter one should be able to understand:

- About Globalisation and its features.

- Essential Conditions for Globalisation.
- Different stages of Globalisation
- Various strategies for entering into foreign market
- Advantages and Disadvantages of Globalisation.
- Various measures taken by Indian Government for globalisation

2.1 INTRODUCTION

The term "globalization" has acquired considerable emotive force. Some view it as a beneficial process, others regard it with hostility believing that it increases inequality within and between nations, threatens employment, living standards and thwarts social progress. .Globalization offers extensive opportunities for genuinely global development, but it is not progressing evenly. Some countries are becoming integrated into the global economy more quickly than others. Countries that have been able to integrate are seeing faster growth and reduced poverty. Outward-oriented policies brought dynamism and greater prosperity too much of East Asia, transforming it from one of the most deprived areas of the world 40 years ago. And as living standards rose, it became possible to make progress on democracy and economic issues such as the environment and work standards. By contrast, in the 1970s and 1980s when many countries in Latin America and Africa pursued inward-oriented policies, their economies stagnated or declined, poverty increased, and high inflation became the norm. In many cases, especially Africa, adverse external developments made the problems worse. As these regions changed their policies, their incomes have begun to rise. A remarkable transformation is underway. Encouraging this trend, not reversing it, is the best course for promoting growth, development and poverty reduction.

The crises in the emerging markets in the 1990s have made it quite evident that the opportunities of globalization do not come without risks—risks arising from volatile capital movements and the dangers of social, economic, and environmental degradation created by poverty. It is not a reason to reverse direction, but for all concerned—in developing countries, in the advanced countries, and of course investors—to embrace policy changes to build strong economies and a more reliable world financial system that will produce more rapid growth and ensure that poverty is reduced.

2.2 WHAT IS GLOBALISATION

Globalization refers to a process of interaction and integration among the people, companies, and government of different nations. It is the process of spreading Western culture and value system, specifically capitalist market culture. It is the process by which the world is becoming increasingly interconnected. It is linking the economy of a nation with the economies of other countries through free trade, free mobility of capital and labour, etc. The International Monetary Fund (IMF) defines Globalization as “the growing economic interdependence of nations worldwide through increasing volume and variety of cross border transactions in goods and services, international capital flow, and widespread diffusion of technology”. It is a mind-set which views the entire world as a single market. It does not differentiate between domestic market and foreign markets. In other words, there is nothing like a home market and the international market. There is only one market that is the global market.

2.2.1 FEATURES OF GLOBALISATION

Globalization is not a new concept, and it has been prevalent for the past many years, but the nature and system of globalization have changed over the years. In the past, it meant the exchange of goods and service between countries without any barriers but in the present scenario apart from goods and services globalization implies the transfer of culture value, jobs, technical knowhow and so many other things. Globalization has become a much broader concept now; let’s look at some of the essential features of globalization:

1. **Efficient Use of Resources:** Globalization leads to more efficient use of world resources because every country has a different set of natural and human resources which results in that country producing particular product at lowest possible price than any other country. The globalization by opening up world markets forces the nation to provide those products which yield the maximum profits.
2. **Quick Transfer of Innovation:** Globalization leads to faster transfer of any invention or discovery made in one country from another country. Those days were gone where one country had to wait for many months to get better and new technological advancement from other countries. Nowadays, the countries get the new technological invention to discover in another country almost instantly, which in turn leads to better efficiency.

3. **Immediate Help:** According to this feature of globalization, during times of natural calamity like floods, earthquakes, famines, all other countries send immediate help to the country which is stuck by natural disaster. It helps in reducing the deaths due to the shortage of basic amenities.
4. **Integration of financial Market:** Integration of financial markets is another important feature of globalization. Due to it, all financial markets of the world interconnected. Hence, one event leads to a reaction is not only the home market, but it has implications over other global markets also. This connection is not limited to the only stock market; instead, it covers the commodity market, currency markets and bond markets even.
5. **Movement Across the World:** According to this feature, due to globalization, people can travel and explore other countries, experience and discover a new culture, food, tradition, and so on. It helps to remove the mental barrier because as people travel, they tend to learn new facts about the other countries and remove many misconceptions they have about other countries. A few decades back if you ask people to develop countries to visit countries in Asia and the African region, they say no. Still, nowadays people go happily to these countries for vacation as well as adventure.
6. **The whole world is a stage:** According to this feature, due to globalization, the world as a whole is open for talented people to show their skills. Whether an individual is an actor or businessmen or sportsmen or in any other field he or she can prove his or her skills and make name and money all over the world which was not possible few decades back. Hence, it provides a platform to people irrespective of their age, religion, ethnicity, and background to make most of their talent.
7. **Creation of New Markets:** Globalization implies a drastic reduction of physical barriers between countries. It has allowed the market to diversify and expand, increasing the production of goods and services. As a result of diversification, new markets have emerged. Some critics of globalization indicate that this has created an ideal platform for countries with enormous wealth to take advantage of the advantages of working with poorer countries since the labour force in these countries is more economical.

2.2.2 ESSENTIAL CONDITIONS FOR GLOBALISATION

There are some essential conditions for successful globalisation of the business that is satisfying on the part of the domestic economy as well as the firm. Followings are the necessary conditions for successful globalisation of firms:

1. **Business Freedom:** According to this condition, there should not be any undue government restrictions such as import restriction, restriction on sourcing finance from abroad, and restriction on foreign investment etc. which come in the way of globalisation. The business has freedom from all types of limitations from the government.
2. **Facilities:** The availability of infrastructure and another type of facility is essential for the development of a firm globally. The extent to which an enterprise can develop globally from home country base depends upon the facilities available like infrastructure facilities.
3. **Government Support:** According to this condition, unnecessary government interference is a hindrance to successful globalisation of firms. Government support helpful in encourage globalisation in the form of policy and procedural reforms, development of infrastructure facilities, research and development support, financial market reforms, and so on.
4. **Resources:** According to this condition, resources is one of the crucial factors for the successful globalisation of firms. It helps decide the ability of a firm to globalise. The resources include finance, technology, R & D capabilities, managerial expertise, company and brand image, human resource etc.
5. **Competitiveness:** According to this condition, the competitive advantage of the firm is a crucial determinant of success in global business. A firm may derive competitive advantage from any one or more of the factors such as low costs and price, product quality, product differentiation, technological superiority, after-sales service, marketing etc.
6. **Orientation:** According to this condition, a global orientation on the part of the business firms and suitable globalisation strategies such as exporting, licensing/franchising, contract manufacturing, management contract, assembly operations, joint venture etc. are essential for globalisation.

2.2.3 STAGES OF GLOBALISATION

Usually, a firm passes through different stages of development before it becomes a truly global or Transnational Corporation. Typically, a domestic firm starts its international business by exporting. Later, it may establish joint ventures or subsidiaries abroad. At last, it may then develop into a multinational or global firm from an international firm.

Ohmae identifies five different stages in the development of a firm into a worldwide corporation. The five steps are:

- **First Stage:** The early stage is the arm's length service activity of the domestic company which moves into new markets overseas by linking up with the foreign local dealers and distributors.
- **Second Stage:** In the second stage, the domestic company enter into new markets overseas by takes over the dealing and distributing activities on its own instead of the foreign local dealers and distributors.
- **Third Stage:** It is the extension of the second stage. In this stage, the domestic company or home country begins to carry out it's manufacturing, marketing, and sales in the key foreign markets.
- **Fourth Stage:** In the fourth stage, the domestic or home-based company moves to a full insider position in the key foreign markets. The company supported by a complete business system including Research and Development (R&D) and engineering. This stage forces the mangers to extend the reach of national headquarters to all overseas activities.
- **Fifth Stage:** In the fifth stage, the company genuinely moves towards the global mode of operation. At this stage, the company becomes a global company. The company starts its services all over the world.

2.2.4 ADVANTAGES AND DISADVANTAGES OF GLOBALISATION

India's economic integration with the rest of the world was minimal because of the restrictive economic policies followed until 1991. The situation is changing now. Globalization is more than just a buzzword. It's changed the way that many companies work and how they approach many aspects of their operations.

Following are the main advantages and disadvantages of globalization:

Advantages of Globalization:

Followings are the main advantages of the globalization:

1. **Employment Opportunities:** According to this, Globalisation helps in generating employment opportunities. It creates employment opportunities for those people who still don't have a job. Most companies today move to a well-civilized country to give a chance to unemployed workers to gain a job that suits their abilities and expertise.
2. **Low or Cheaper Price:** According to this, globalization increases the inflow of foreign technology from superior and advanced developed nations. These modern technology helps produce goods and services at a lower or cheaper price.
3. **Encourage Free Trade:** According to this, globalization encourages the free trade of goods and services across borders without imposing any tariff or taxes. When there are fewer complications for consumers, then there are more opportunities for them to purchase products or services. It helps create an environment where competition encourages free trade at lower prices.
4. **Better Communication:** According to this, globalization encourages open lines of communication with the rest of the world, which is helpful in cross border transactions. If the world had fewer borders, then it would be easier to communicate with one another without requiring the Internet to do so. Communication makes us stronger as humans because it gives us access to more information. The technology today allows people to achieve precise and continuous contact with their family or VIP in different countries.
5. **Improvement in Standard of living:** As a result of globalization, the Standard of living of people improves. Due to globalization, people get quality goods at cheaper or lower prices. It helps in improves their Standard of living.
6. **Expansion of Market:** According to this, globalization helpful in the development of market size. It allows the business units to expand their business in the whole world by opening up branches. Globalization opens up new opportunities for companies to sell their goods and services to much larger markets.
7. **Development of Capital Market:** According to this, globalization is helpful in the growth of the capital market. As a result of globalization, many foreign investors starting investment

activities in the capital market in the form of foreign direct investment and international portfolio investment.

8. **Increase in Foreign Collaboration:** According to this, globalization promotes international collaboration with the firms in the form of technical cooperation, financial cooperation or both. In financial partnership, the foreign company provide financial assistance to the firm, while in technical collaboration provide modern technology to the firm.
9. **Transfer of Technology:** Globalization acts as a mechanism for transmission of the technology from the developed countries to the under-developing countries like India. The present technology available in India is obsolete. So the Indian companies approach to the developed foreign countries for technological up gradation. Because of Globalization, Indian companies get advanced technologies from developed countries that lead to higher productivity and industrial growth.
10. **Education:** Globalization made it easy for those who want to move across the border to acquire better knowledge. People from underdevelopment countries have started to move to developed countries to get a better education. This migration for education opens new doors for the integration of cultures.

Disadvantages of Globalization:

Followings are the main disadvantages of globalization:

1. **The loss to Domestic Industries:** As a consequence of globalization, foreign competition increases. Now, domestic industrial units have to compete with international industrial groups. These industrial units are producing quality goods and services at a low cost. Because of this, local industrial units fail to compete with them and close down.
2. **Unemployment:** According to this, international industrial units use capital intensive technology in the production of goods and services. It increases the unemployment rate and reduces employment opportunities.
3. **Political Interference:** As a consequence of globalization, global companies interference in the economic and political freedom of host countries. These companies interference in the politics of

the host country nationals. They make all efforts to bring that political party to power in the host country, which is favourable for their business.

4. **Unbalanced Regional Development:** According to this, globalization leads to uneven regional development. The industrial units set up industries in those develop cities and towns where infrastructure facility readily available and not in backward areas. As a result, local disparity increases.
5. **Tax Evasion:** As a consequence of globalization, the domestic or host nation government imposes various types of tax on the income of the companies such as corporate tax. Foreign industrial units reduce their profits by adopting transfer pricing methods to avoid taxes. The international groups buy intermediate goods from their subsidiaries abroad at a high price to reduce local benefits. In other words, global companies over invoice the imports and under invoice the exports to show fewer profits.
6. **Adverse Effect on Culture and Value System:** According to this, many industrial units sell such products which distort our culture and value system. The vulgar advertisements shown by some multinational companies harm the thinking of a young generation. Some MNCs promotes the unethical and corrupt practices for their self-interest. These MNCs do not hesitate to offer bribes to high officials of the host nation to serve their self-interest.
7. **The exploitation of Labour:** As per the consequences of globalization, it is exploiting the unskilled workers by giving lower wages, less job security, and long working hours. The workers have to work even in these conditions because bad jobs and fewer salaries are better than no posts.
8. **Production of Prohibited Goods:** According to this, to gets more profits, global companies indulge in the production of those goods which are harmful to the consumers. These goods are a ban in their parent nations. Global companies earn profits even at the cost of the health of consumers.
9. **Dominant Global Brand:** In the era of globalization, the competition has reached its peak, and in such a competitive environment, it becomes difficult for the small industries to survive. The dominant global brands don't let the small enterprises to grow. Superior technologies hold the

most of market share and for new and small industries to keep a good grip on the market becomes a challenge.

10. **Environmental Degradation:** The environment has suffered dramatically due to globalization. On the one hand, the increase in traffic between countries polluted tourist destinations. On the other hand, the poisonous gases released into the air by large industries have increased environmental pollution. The globalized business has exploited the natural resources of the earth beyond the tolerable limit. Some places on earth, which was once abundant in minerals and forests can no longer claim their richness.

2.3 STRATEGIES FOR ENTERING INTO FOREIGN MARKET

One of the most critical strategic decisions in international business is the mode of entering into the foreign market. On the one extreme, a firm or company may do the complete manufacturing of the product domestically and export it to the international market. On the other height, a company may do a full production of the product in the foreign market itself. There are several alternatives strategies between the two extremes. Following are the main strategies adopt by a firm or company to become a global firm or company:

- **Export:** Export is the most traditional mode of entering the foreign market. In exports, goods and services produce in one country are purchase by residents of another country. It doesn't matter what the good or service is. It doesn't matter how it is sent. It can be shipped, sent by email, or carried in personal luggage on a plane.
- **Licensing:** Under international licensing, a firm or licensor in one country permits a firm or licensee in another country to use its intellectual property rights such as patents, trademarks, copyrights, technology, technical know-how, marketing skills etc. The licensee pays royalty or fees to the licensor for the licensing.
- **Franchising:** Franchising is a form of licensing in which a parent company or the franchiser grants another independent company or the franchisee right to do business in a prescribed manner. This right can take the form of selling the franchisor's products, using its name, production and marketing techniques. In return, the franchisee pays specific fees and agrees to comply with certain obligations, typically set out in a franchise agreement.

- **Contract Manufacturing:** Contract manufacturing is a process that establishes a working agreement between two companies. In contract manufacturing, one company arranges for a company located in a different country to handle the manufacturing process of its products.
- **Management Contracting:** Management contracting is a low-risk method of getting into a foreign market. It is a contractual arrangement under which operational control of a company lies in the hands of another company that performs the necessary managerial functions for a fee.
- **Turnkey Contracts:** The turnkey contract is a business arrangement in which a project is delivered to the owner in a complete state by the developing company without owner input. Under the turnkey contract, the contractor is responsible for both the design and construction of a project at the agreed price and finishes it on a fixed date.
- **Joint Ventures:** It is a common strategy of entering into the foreign market. A joint venture is a business arrangements form by two or more companies in which one company is an international company that agrees to pool their resources for the accomplishment of the common objective. This objective can be a new business project or any other business activity. It is a temporary contract between participating companies that dissolves at a specific future date or on completion of the project.
- **Wholly Owned Manufacturing Facilities:** A company with long term interest in a foreign market establishes utterly owned manufacturing facilities. Several factors like trade barriers, cost differences, government policies, and so on encourage the setting up of production facilities in foreign markets. Manufacturing abroad provides the firm with total control over quality and production.
- **Third country Location:** Sometimes, third-country location is used as an entering strategy into a foreign market. When there are no commercial transactions between two countries due to reason like political conditions firm which wants to enter into the market of another nation, will have to operate from a third country base. It is helpful to take advantage of the friendly trade relations between the third country and foreign market concern.
- **Mergers and Acquisition (M&A):** The term mergers and acquisitions (M&A) refers to the process of one company combining with another. A merger is the combination of two firms,

which subsequently form a new legal entity under the banner of one corporate name. On the other hand, in an acquisition, one company purchases the other outright. The acquired firm does not change its legal name or structure.

- **Strategic Alliance:** This strategy as an entering approach in foreign market helpful in enhancing the long term competitive advantage of the firm by an alliance with its competitors. In a strategic partnership, two or more businesses join hands to pursue mutual interest through combining their resources, capabilities and core competencies for a set period.
- **Assembly Operations:** It is a variation of the subsidiary. In assembly operations, a foreign production plant is set up in international markets to assemble the parts or components of product manufacture in the domestic company or elsewhere. The establishment of assembly operation represents a cross between exporting and overseas manufacturing.
- **Countertrade:** It refers to the reciprocal exchange of goods and services with other products and services rather than with money. This type of international trade is more common in developing countries who have limited foreign exchange or credit facilities. Countertrade takes several forms. In any way, it provides a mechanism for countries with limited foreign exchange or credit facilities to exchange goods and services with other nations. The followings are the most common form of the countertrade:
  - **Barter:** It is the oldest form of countertrade. In the barter, the direct exchange of goods or services takes place between two parties with other products or services without the use of money as a means of purchase or payment.
  - **Counter purchase:** It refers to the sale of goods and services to a company in a foreign country by a company that promises to make a future purchase of a specific product from the same company in that country. In counter purchase arrangement, the exporter receives the full payment in cash but agrees to spend an equivalent amount of money in importer country within a specified period.
  - **Buyback:** Under the buyback agreement, the supplier of plant, equipment, or technology agrees to purchase goods manufacture with that equipment or technology. For example, company A builds a salt processing plant in country B. In return, country B pays partly in cash and rest in salt from the plant to the company A.

- **Compensation Deal:** It refers to that form of countertrade in which the seller of goods and services receives a part of the payment in cash and the rest in products for their selling.
- **Switch Trading:** It refers to that form of countertrade in which one company sells its obligation to another company known as switch trader to purchase in a given company. For example, Two Companies' A' and 'B' are counter trading salt for sugar. The switch trader gets the sugar from Company B at a discount and sells it for money uses as payment to company B.

2.4 MEASURES ADOPTED BY INDIAN GOVERNMENT FOR GLOBALISATION

Indian economy is one of the fastest-growing economies in the world. But it was a completely different scenario in 1991, the year in which new policies and reforms introduced. The year which serves as a backbone to many of the current policies and decisions. It was during 1991 that India met with the economic crisis which occurred due to its external debt liability. Due to obligation, the government was not able to make the payments for the borrowings it had made from the foreign countries. As a result, the government had to adopt new measures to reform the conditions of the Indian economy. There were many programs and initiatives introduced primarily consisted of liberalization, privatization, and globalization. Following are the leading measures which are adopted by the Indian government to promote globalization in India:

1. **Increase in Foreign Investment:** Under economic reforms, the limit of foreign capital investment has been raised. In many Industries, foreign direct investment (FDI) has been allowed to the extent of 100 per cent without any restriction. Foreign Exchange Regulation Act (FERA) 1973 replaced with the more liberal act that is the Foreign Exchange Management Act, 1999. Many incentives are given to Non-Resident Indian (NRI) to motivate them to invest in India. Table 13.1 shows the foreign investment limits in different sectors.

Table 13.1 Foreign Investment Limits

Sr. No.	Sectors	Foreign Investment Limits
1.	Infrastructure	100 % FDI investment through automatic route is permitted in construction sectors of cities and towns.

2.	Automotive	100 % FDI investment is permitted through automatic route this sector.
s3.	Pharmaceuticals	74 % FDI investment is permitted in this sector
4.	Insurance	49 % FDI limit is permitted in this sector
5.	Railways	100 % FDI is allowed under automatic route in most areas of railway other than operations like High speed train, railway electrification, passenger terminal, mass rapid transport systems etc.
6.	Chemicals	100 % FDI is allowed under automatic route in this sector except Hydrocynic acid, Phosgene, Isocynates and their derivatives.
7.	Textile	100 % FDI is allowed under automatic route in this sector.
8.	Airlines	100 % FDI is allowed in a scheduled or regional air transport service or domestic scheduled airline.

2. **Partial Convertibility of Indian Rupee:** It was introduced in March 1992. It refers to the freedom to convert domestic currency into foreign currency and vice-versa. It called partial convertibility because it covers only current account transactions. Under the partial cover ability of the rupee, the dispensation of 40% of the foreign exchange surrendered to RBI at the official rate, and balance of 60% of the foreign exchange dispose-off by the exporter at market rate. The primary objective of partial convertibility of rupee was to make the foreign exchange available at a low price for essential export-import transactions.
3. **The liberal and Long term Foreign Trade Policy:** In conformity with economic reforms, foreign trade policy was enforced for a long duration, viz., five years. India's present international trade policy 2015-20 is a liberal and long term policy. Under this policy, various restrictions and controls on foreign trade have been removed. Open competition has been encouraged. Administrative controls have also been minimized.
4. **Reduction in Tariffs:** Under new economic reforms, custom duties and tariffs imposed on imports and exports reduced gradually to promote foreign trade of India.

5. **Export Promotion Measures:** Export promotion measures are public policy measures taken by the government of a country to enhance the export and import of goods and services of that country. In India, many export promotion schemes like the establishment of Export Processing Zones (EPZ), Free Trade Zone (FTZ), and Special Economic Zones (SEZ) provides to the exporters to increase the share of Indian exports in world trade.
6. **Freedom to Repatriate:** Until the new economic policy, foreign investment was allowed on non-repatriation basis in India. It means foreign investors cannot take their income on foreign investment back to their country without prior permission of RBI. The Reserve Bank of India (RBI) allows this repatriation on a very restrictive basis. But as per new economic policy reforms, the investor is free to repatriate their investment income.
7. **Increase in Foreign Technology Agreements:** Under the new economic reforms, the government allows the import of foreign technology through foreign technology agreements with foreign countries. Indian companies are now allowed to hire external technicians without prior permission of RBI. The companies have not required the approval of RBI to make payment for foreign technology and technicians.
8. **Setting up Joint Ventures:** Under the new economic reforms, the conditions for setting up joint ventures in abroad are modifying and liberalize. The foreign investors can own even more than 51% share capital in a joint venture set up in India. A more liberal act Competition act, 2002 replaces the MRTP Act, 1969 to remove the obstacles of global merger and acquisition.
9. **Setting up of Foreign Investment Promotion Board:** The Foreign Investment Promotion Board (FIPB) was an inter-ministerial body under the Department of Economic Affairs in the Ministry of Finance set up in 1991 for the facilitation of foreign trade in India. This board arranges conferences in India as well as in foreign nations to attracts foreign investor. The Foreign Investment Promotion Board (FIPB) is now replaced by the Foreign Investment Facilitation Portal (FIFP) to speed up the FDI inflow and to increase the transparency in the FDI approvals in May 2017.
10. **Liberalization:** Under the new economic reforms, Indian government liberalize foreign trade policy, foreign investment policy, industrial and licensing strategy, and taxation policy to promote foreign investment. The government also simplified procedural, forms, documents norms related to

international trade and investment. The Single Window Clearance Scheme has been started for promoting foreign investment and to reduce bureaucratic, lengthy, and cumbersome procedures.

11. **Privatization:** Under new economic reforms, the private sector is allowed to set up units in those industries which were previously reserve for the public sector. The number of industries reserve for the public sector has been reduced from 17 to 2.
12. **Market Determine Exchange Rate:** Under new reforms, An essential measure in external sector was to devalue the rupee in July 1991 and after about two years in 1993 exchange rate was changed from basket based pegged exchange rate system to the market-determined exchange rate. With this, the exchange rate of the rupee today determined by demand and supply conditions in the foreign exchange markets.

2.5 CHECK YOUR PROGRESS

State whether the following statements are true or false:

1. Globalization has restored much of the global dominance of the former imperialist powers, such as Western Europe, Japan, and above all the US.
2. Globalization refers to the greater interconnectedness among the world's people.
3. Globalization is a new phenomenon
4. Globalization has changed the structure of work. Worker security worldwide has increased. Labour unions have gained more of their power
5. Globalization, can collaborate and compete in real time with other people on more different kinds of work using computers, email, fibre-optic networks, teleconferencing, and dynamic software.
6. One of the negative impacts of globalisation is that it reduces employment opportunities.
7. With increase in globalisation, there is constant switch over of jobs which can affect the organisations adversely.

2.6 SUMMARY

Globalization is not a new concept, and it has been prevalent for the past many years, but the nature and system of globalization have changed over the years. Globalization refers to a process of interaction and integration among the people, companies, and government of different nations. It is linking the economy of a country with the economies of other nations through free trade, free mobility of capital and labour. Efficient use of resources, quick transfer of innovation, immediate help, integration of financial market, movement across the world, the whole world as a stage, and creation of new markets are the main features of the globalization. Business freedom, facilities, government support, resources, competitiveness, and orientation are the essential conditions of successful globalization.

Usually, a firm passes through different stages of development before it becomes a truly global or Transnational Corporation. Ohmae identifies five distinct stages of development of a firm into a worldwide corporation. Globalization has both positive and negative effects on the Indian economy. Employment opportunities, lower price, encourage free trade, better communication, improve the standard of living, expansion of the market, development of the capital market, increase in international collaboration, transfer of technology and education are the main advantages of the globalization. The disadvantages of globalization include loss to domestic industries, unemployment, political interference, unbalanced regional development, tax evasion, the lousy effect on culture and value system, exploitation of labour, production of prohibited goods, the dominance of global brand and degradation of the environment.

Export, licensing, franchising, contract manufacturing, management contracting, turnkey contract, joint venture, wholly-owned manufacturing facilities, third-country location, merger and acquisition, strategic alliance and countertrade are the various modes of entering into a foreign market. The government of India is also adopting different measures to promote globalization in India. These measures include the partial convertibility of Indian rupee, reduction in tariff, export promotion measures, adoption of the market-determined exchange rate, setting up of joint ventures and Foreign Investment Promotion Board.

2.7 KEYWORDS

- **Globalisation:** Globalization is refers to a process of interaction and integration among the people, companies, and government of different nations.
- **Export:** An export is the shipping of domestic goods and services to a foreign country.
- **Licensing:** Licensing is a business arrangement in which one company gives another company permission to manufacture its product for a specified payment.

- **Franchising:** Franchising is a form of business by which the owner (franchisor) of a product, service or method obtains distribution through affiliated dealers (franchisees).
- **Management Contract:** It is an contractual arrangement under which operational control of a company is vested in the hands of another company that performs the necessary managerial functions for a fee.
- **Joint Venture:** A joint venture is a business arrangements form by two or more companies agrees to pool their resources for the accomplishment of common objective.
- **Countertrade:** Countertrade is a reciprocal form of international trade in which goods or services are exchanged for other goods or services rather than for hard currency.
- **Compensation Deal:** It refers to that form of countertrade in which the seller of goods and services receives a part of payment in cash and the rest in products.
- **Switch Trading:** It is practice in which one company sells to another its obligation to make a purchase in a given country.

2.8 SELF-ASSESSMENT TEST

1. What do you mean by Globalisation? What are the main features of Globalisation?
2. What is Globalisation. Explain the essential conditions of Globalisation.
3. Explain the Ohmae five stages of globalisation.
4. What is Globalisation? Explain the main advantages and disadvantages of Globalisation.
5. What do you mean by Countertrade? Explain the various forms of countertrade.
6. Explain the various modes of entering into foreign market by a domestic company.
7. What is Globalisation? Explain the various measures adopted by the Indian Government to promote the globalisation in India.

2.9 ANSWER TO CHECK YOUR PROGRESS

Answer of statements of true or false:

1. True
2. True

3. False
4. False
5. True
6. False
7. True

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Modes of Entry into International Business

STRUCTURE

3.0 LEARNING OBJECTIVES

Entry mode is a structural agreement that allows an international company to implement its strategy to enter in a host country either by itself or in partnership with others. The objective of this chapter is to get the students acquainted with the basic concept of entry methods in markets abroad.

After reading this chapter, students will be able to:

- Describe the concept of modes of entry in international market
- Explain different types of factors of selection of mode of international business
- Importance of entry methods in international business
- Understand how companies enter into foreign markets through case studies

3.1 INTRODUCTION: MODES OF INTERNATIONAL BUSINESS

International Business includes business transactions like establishing production bases in the global markets, availability of products and services in different international markets, and managing high skilled human resources from the whole world. International business activities in host country involve investment in intellectual properties like, patents, trademarks, copy rights and strategically management of international services like logistics, warehousing, banking, advertising, tourism, construction, agriculture activities, online and offline retail management, etc. More and more MNCs are sourcing manpower globally. In this environment, the managers'role becomes dynamic as he needs more knowledge about the mentioned areas and he has to play powerful role to determine the competitiveness of his business in the global market. Internationally developing economies have huge potential in huge markets, more and more trading blocs like SAARC, European Union (EU), ASIAN, BRICS, NAFTA, APEC, MERCOSUR, etc., are adding pace to globalisation. MNCs are finding opportunities in the globalised word and parking their funds as well as locating their subsidiaries mainly in the search of low cost of resources, labour, wages, low cost of production. Further, declining trade and investment barriers and technology have added pace of globalisation and given boost to international business. So, in this global scenario, it become upmost important to study the modes of international business. Entry mode is a structural agreement that allows an international company to implement its strategy to enter in a host country like carrying out its marketing operations or production operations, or both marketing operations & production operations there by itself or in partnership with others.

3.2 FACTORS OF SELECTION OF MODE OF INTERNATIONAL BUSINESS

Which particular mode a firm should adopt depends upon the following five factors: (a) Corporate Objectives (b) Corporate Resources and Capability (c) Host Country Business Environment (d) Control and Perceived Risk and (e) Competition.

- **Corporate Objectives**

  Corporate objectives are most important factors behind the selection of mode of international business. As for example, in the case of no control trading is best and if control is primary objective then wholly owned subsidiary is the best option.

- **Corporate Resources and Capability**

  The modes of international business depend on the corporate resources and capabilities. The strategic decision of selection of mode of international business depends on financial position is strong or not.

- **Host Country Business Environment**

  There are many factors in the business environment of the host country like regulatory, cultural, political, legal, economic, size of market, production, shipping cost, values, beliefs, customs, language, religion. The strategic decision of selection of mode of international business depends on these factors.

- **Control and Perceived Risk:** More control, more risk and less control, less risk in the selection of mode of international business.

- **Competition:** The competition in the host country is a very important factor in the selection of mode of international business.

3.3 MODES OF INTERNATIONAL BUSINESS/ GLOBALIZATION /INTERNATIONAL TRADE

There are three different modes of international business categorised into (1) International Trade (2) Contractual Entry Mode and (3) Investment Mode. All the modes differ in risk, return of investment, resources requirement and control.

- **International Trade:** (i) Direct & Indirect Export (ii) Counter Trade
- **Contractual Entry Mode:** (i) Licensing (ii) Franchising (iii) Management Contracts (iv) Trunkey Projects
- **Investment Mode:** (i) Merger & Acquisition, (ii) Foreign Portfolio Investment (FPI) (iii) Foreign Direct Investment (FDI)

3.3.1 International Trade (Exporting)

There are a number of ways in which organisations can enter foreign markets and the most traditional and well established form of operating in foreign market is exporting. The main advantage of exporting is that the manufacturing is home country based so there is less risk. It is a low cost foreign market entry strategy. Moreover, exporting gives opportunity to learn in overseas markets. The key disadvantage is the company lost the control as company has to depend on overseas agents. The exporter has to remain alert equipped with tariff and non tariff barriers and foreign exchanges fluctuations every time. In exporting, the company gets less chance to learn consumer behaviour, competitors and overseas marketplace. There are two types of export (i) direct Export (ii) indirect export.

(i) Direct Export

A company takes full responsibility for making its goods available in the target market by selling directly to the end-users. The exporter contracts with intermediaries in overseas markets like distributors or agents to perform some value chain activities in target market.

(ii) Indirect Export

The exporter contracts with intermediaries in the company's own market to perform export functions in overseers market. In indirect export, the exporting company sells its products to intermediaries (Export Management Companies (EMCs) and Trading Companies), who in turn sell the same products to the end users in the target market. When an EMC functions as a distributor; it takes title to goods, sells them on its own account, and assumes the trading risk. Alternatively, when it acts as an agent, it charges a commission. The intermediaries resume the responsibility of finding buyers/importers, shipping products, getting payments etc. Trading Companies provide services to exporters in addition to exporting activates.

(iii) Counter Trade: It is a sort of bilateral trade where one set of goods is exchanged for another set of goods.

3.3.2 Contractual Entry Mode

Contractual entry modes are found in case of intangible products such as technology, patents, and so on. When a company develops a particular technology through its own research and development programme, it likes to recover the cost of research and development. If the company does not possess enough capital for investment and does not have knowledge of foreign market, it sells the technology in the domestic firm. If the company has resources, then it wishes to exploit its technology in the foreign market. There are four contractual entry modes as following: (i) Licensing (ii) Franchising (iii)

Management Contracts (iv) Trunkey Projects

(i) Licensing

Licensing is an arrangement by which a firm transfer its intangible property such as expertise, know-how, blueprints, technology and manufacturing design to its own unit or to a firm, located abroad. It is also known as technical collaboration. A license can be exclusive, non-exclusive or cross.

Advantages of Licensing

- A licensor can expand its operation in different countries by exploiting its technology, without making any investment.
- It is less risky because as it does not commit any investment.
- In an unfavourable political climate in host country, the licensor is not going to loose anything.
- Licensing can be advantageous to the licensee too as it is able to upgrade its production technology and can develop its competitiveness in the international market.

Disadvantages of Licensing

- There are changes of inconsistency of the quality and marketing of licensor‘s products in overseas market.
- There are changes of secrecy of the technology is known to the licensee.

(ii) Franchising

- Franchising is a form of technical collaboration for granting the right by a parent company (the franchiser) to another (the franchisee) to do business in prescribed manner.
- In involves the franchisee to make use of intellectual property rights, like trade-marks, copyrights, business know-how, managerial assistance, geographical exclusively or of a specific set of procedures of the franchiser for creating the product.
- The right can take the form of selling the franchiser‘s products, using their name, production and marketing techniques or using its general approach.
- Franchising agreement typically involves the payment of a fee upfront and then a percentage on sales.
- It provides franchiser a new stream of income and the franchisee with a time proven concept and products that can be quickly brought to the market.
- Food, bakery, restaurant, fast food, real estate, school, retail-computers, clothing, shoes, travel, furniture, hair care, placement services, repair, advertising agencies, law practices, etc., are some of the examples of franchising.

Advantages of Franchising

- It allows the franchiser to maintain consistency of its standard products in different target markets.
- It is a low-risk mode of entry in different markets.

Disadvantages of Franchising:

- Sometimes there may be problem of controlling & monitoring the operations in a large number of franchising in different markets.
- Search cost, serving cost, property right protection cost, monitoring cost are high.

(iii) 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.

(iv) Turnkey Project

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.

3.3.3 Investment Mode

Investment mode covers: (i) Foreign Portfolio Investment (FPI) (ii) Foreign Direct Investment (FDI) (iii) Merger & Acquisition

(i) Foreign Portfolio Investment (FPI)

Foreign Portfolio Investment is an investment in the shares and debt securities of companies abroad in the secondary market nearly for sake of returns and not in the interests of the management of the company.

(ii) Foreign Direct Investment

It is the form of green-field investment in the equity capital of a company aboard for the sake of the management of the company or investment abroad through opening of the branches. FDI is either horizontal or vertical.

- **Horizontal FDI** is said to exist when a firm invests abroad in the same operation / industry.
- **Vertical FDI** exists when a firm invests aboard in other operations either with a view to have control over the supply of inputs or to have control over marketing of its product.

FDI vs Trade

- Different markets can better be served with different products.
- FDI overcomes tariff and transport cost involved in trade.
- It is better means to acquire resources from the host country.
- It reduces financial risk through greater diversification.
- It creates harmonious political relations.

(iii) Merger & Acquisition: Merger and acquisition are either outright purchase of a running company abroad or an amalgamation with a running foreign company. These are also called Brown- field Investment (refers to mergers and acquisition) followed by fresh doses of green-field investment.

Forms of M&As

- **Based on corporate structure:** (i) Acquisition (ii) Amalgamation/ consolidation
- **Based on financial relationship:** (i) Horizontal (ii) Vertical (iii) Conglomerate
- **Based on technique:** (i) Hostile (ii) Friendly

International M&A is preferred where:

- Domestic market is saturated.
- High tariff exists in host country.
- Firm possesses superior technology to take a lead in host country.
- Host country is a regular source of raw material.

3.4 CHECK YOUR PROGRESS

1. A company is planning to enter an international market. Which of the following mode will give it the maximum control?

   (A) Direct export (B) Direct investment

   (C) Financing (D) Licensing

2. KFC operates fast food restaurants the world over through which mode of international business?

   (A) Licensing (B) Franchising

   (C) Trademarks (D) Joint Venture

3. A project where the facility is built from the ground and turned over to the client ready to go.

(A) Licensing (B) Franchising

(C) Turnkey Projects (D) Joint Venture

4. The main disadvantage of franchising is:

(A) Loss of trademark (B) Loss of identity

(C) Loss of control (D) Loss of market

5. The agreement signed by Ranbaxy Laboratory and Bayer AG of Germany in the year 1999 is an example of:

(A) Subsidiary

(B) Joint venture

(C) Strategic international alliance

(D) License agreement

State whether the following statements are True or False:

6. Contract manufacturing is a process that established a working agreement between two companies.

7. Contractual entry mode is found normally in the case of intangible products, such as technology.

8. While franchising involves transfer of total business function, licensing is concerned with a single product or process.

Fill in the blanks

9. _____________is a form of foreign direct investment where a parent company starts a new venture in a foreign country by constructing new operational facilities from the ground up.

10. _____________refers to the methods of practicing and using another person's business philosophy.

11. When investments in production and marketing facilities are made jointly with one or more foreign parties, such an operation is called____________.

12. In case of_________________the businessman does not have to hire a facility or labour in order to get finished goods.

13. Contract manufacturing works only if the company gets involved with the ________ company.

3.5 SUMMARY

MNCs are finding opportunities in the globalised word and parking their funds as well as locating their subsidiaries mainly in the search of low cost of resources, labour, wages, low cost of production. Further, declining trade and investment barriers and technology have added pace of globalisation and given boost to international business. So, in this global scenario, it become upmost important to study the modes of international business. Entry mode is a structural agreement that allows an international company to implement its strategy to enter in a host country like carrying out its marketing operations or production operations, or both marketing operations & production operations there by itself or in partnership with others.

Which particular mode a firm should adopt depends upon the following five factors: (a) Corporate Objectives (b) Corporate Resources and Capability (c) Host Country Business Environment (d) Control and Perceived Risk and (e) Competition.

There are three types of different modes of international business categorised into (1) International Trade (2) Contractual Entry Mode and (3) Investment Mode. International Trade consists of (i) Direct & Indirect Export (ii) Counter Trade, Contractual Entry Mode cover (i) Licensing (ii) Franchising (iii) Management Contracts (iv) Trunkey Projects and Investment Mode: (i) Merger & Acquisition, (ii) Foreign Portfolio Investment (FPI) (iii) Foreign Direct Investment (FDI). All the methods differ in risk, return of investment, resources requirement and control.

3.6 KEYWORDS

Counter Trade

It is a sort of bilateral trade where one set of goods is exchanged for another set of goods.

Licensing

Licensing is an arrangement by which a firm transfer its intangible property.

Franchising

Franchising is a form of technical collaboration for granting the right by a parent company (the franchiser) to another (the franchisee) to do business in prescribed manner.

Foreign Portfolio Investment

Foreign Portfolio Investment is an investment in the shares and debt securities of companies abroad in the secondary market nearly for sake of returns and not in the interests of the management of the company.

3.7 SELF- ASSESSMENT TEST

Q.1 Discuss the strategic decisions that a business has to make before going to the international level.

Q.2 What factors should be kept in mind while entering into international market?

Q.3 Describe the term "franchising". Discuss the merits and demerits of this mode of entry in international market.

Q.4 Explain different modes of entry in international trade with examples.

Q.5 Elaborate the benefits of a foreign direct investment over portfolio investment.

Q.6 Describe the benefits of exporting.

Q.7 If you are a manager of FMCG company in India, which option would you choose to enter into international business?

Q.8 Is exporting a safer option than FDI? Justify your answer.

3.8 ANSWERS TO CHECK YOUR PROGRESS

1) B	(2) B
(3) C	(4) C
(5) C	(6) True
(7) True	(8) True
(9) Greenfield investment	(10) Franchising
(11) Joint venture	(12) Contract Manufacturing
(13) Right	

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Business Environment- National & International Aspect	

STRUCTURE

4.0 LEARNING OBJECTIVES

The environment of international business is regarded as the sum total of all the external forces working upon the firm as it goes about its affairs in foreign markets. The objective of this chapter is to get the students acquainted with the external forces of the international business environment and the factors contributing in the growth of the international business.

After reading this chapter, students will be able to:

- Describe the concept of International Business Environment
- Explain different types external factors of international business environment
- Importance of studying international business environment
- Understand the factors contributing in the growth of the international business

4.1 DOMESTIC AND INTERNATIONAL BUSINESS

There are many variables which affect business directly or indirectly. There is a big difference in domestic business and international business as more variables affect international business than domestic business. Handling the external variables or factors create the difference between doing business internationally and doing business at domestic level.

In every new global market, the executives have to learn new skills and acquire new knowledge to be successful. They have to face different culture, the different customer buying habits, tastes, preferences, choices and they have to learn different laws and regulations. They have to manage marketing and advertising strategies according to the new country you are entering. It is important to remember that the way you operate your business will be determined by culture of the market you are entering, not yours. Moreover, international businesses must ensure, and maintain very high standards in the quality of products or services offered. The standards applied should fit the standards that are accepted globally. The multinational companies usually opt various ISO standards for matching the quality of their products with international levels. An international business must be researched extensively so as to understand the consumer needs, wants and demands, and behavior. It is very difficult to handle factors of production, supply chain management, logistics facilities etc in global markets.

Table 1.1: Difference between International Business and Domestic Business

Issues	Domestic Business	International Business
Geography	It is carried out within the national or geographical borders of a country.	It is carried out across borders and national territories of a country. It can happen in more than one country.
Business Environment	The companies face variables of domestic environment	International business environmental factors affect the business
Culture	There is less difference in the culture of local areas and regions within the domestic country. The culture is relatively uniform.	The culture widely varies in different countries and regions.
Quality of products/ services	Standards may be lower.	Very high standards are expected and enforced. Global standards are set
Currency	Domestic business deals with single currency. It mostly depends on local currency for transactions.	It depends on foreign currencies for transactions. Companies deal with multiple currencies.
Research	It is easy to conduct research for the business as the companies are dealing with local variables.	Research processes for the business is very expensive and hard to conduct as the companies are dealing with multiple variables.
Investment	The capital investment is not high and manageable.	Capital investment is extremely high and requires special skills to manage.
Production factors	Factors of production are free and easily available.	Factors of production are not freely and easily available.

Human Resource	The local companies may succeed with low skills and knowledge.	In international business, manpower is very important. It must be having high IQ, EQ and must be multilingual and multicultural as well.
Promotion Strategies	Domestic marketing and advertising strategies are successful.	Marketing and advertising strategies vary from country to country due to cultural differences, mainly language differences.
Rules and Regulations	Only local rules and regulations are applicable	International and host country rules and regulations are applicable
Risk Factors	Risk factor is less	Risk factor is vary high.
Cost Advantage	Companies may not enjoy cost advantage	Companies may enjoy cost advantage due to achieving economies of scale

It can be concluded that the domestic companies are facing very difficult business environment whereas in international business the companies have to face varying environmental factors like political, legal, economic, socio-cultural and ethical in host countries, often not known to the firm. The big multinational companies are getting benefit of intra-firm transactions using transfer pricing, which is a common practice. The companies are facing the presence of political risk and also of exchange rate risk, sometimes leading to financial risk in host countries. They have to opt varying strategies of business in different host countries as well.

4.2 EXTERNAL FORCES OF INTERNATIONAL BUSINESS ENVIRONMENT

The companies engaged in international business have to anticipate and analyze the international business environmental. Before entering into international market, a company must analyse the international business environment factors very carefully because the future of the company depends on this analysis only. After entering into international market, the companies have to be more cautious as the international business environment changes really fast, so, the requirement to analyse the international business environment is regular and constant. A company needs to analyse the political, legal and regulatory, socio-cultural, economic, and technological environment in order to understand the international business environment.

The environment of international business is regarded as the sum total of all the external forces working upon the firm as it goes about its affairs in foreign markets. The foreign environment can be taken as those factors which operate in those other countries within which the MNC operates. The forces are Political Environment, Legal & Regulatory environment, Social & Cultural environment, Technological Environment and Economic environment.

4.2.1 International Political Environment

Political events could harm the business. The political environment in international business consists of a set of political factors like political/economical relationships with other country or confrontation between two or more governments, political unrest, violence, labour strike and protests, government activities related with taxation, tariff/non-trariff barriers, economic sanctions etc in a foreign market that can either facilitate or hinder a business' ability to conduct business activities in the foreign market. It refers to the influence of the system of government and judiciary in a nation on international business. But, not all the political events harm the business. There is no universal solution to handle the political risk as the risk management is very sensitive and complex but the political events could be proactively anlaysed and detected in advance to lower down the risk.

The Type and Structure of Government

The type and structure of government prevailing in a country decides, promotes, fosters, encourages, shelters, directs, and controls the business of that country. Like democracy refers to a political arrangement in which the supreme power is vested to the people, for the people and by the people. Stable, honest, efficient, and dynamic political system gives stable and consistent policies which leads or boost ultimate confidence in the foreign investors to carry on more investments and generating new projects. Democracies maintain stable business environments primarily through laws protecting individual property rights, gives freedom of speech and generates supportive values as for example India.

Political Risk

There are so many factors/variables which could affect company‘s performance adversely if not managed or accessed and analysed timely. These types of mismanagement could generate high degree of uncertainty when conducting business in a foreign country. Most important variables in international market are sudden change in the government policies, terrorism, war, sanctions and disagreement between countries.

A political risk is the risk of sudden change in government policy, might be because of change in the political party/government, terrorism, war, sanctions and disagreement between countries that could adversely impact a company ability to operate effectively and profitably. When political risk is low, the country attracts more foreign investments in the form of Foreign Direct Investments (FDI). Situations like elections, demonstrations, riots, human rights violations, terrorist activities, or bad relationship among countries could create uncertainty in business environment or generate political risk.

Political Environment and International Business

- As a firm expands internationally and begins to operate in multiple countries, the political environment becomes increasingly more important. Generally, the multinational companies (MNCs) like to invest in the countries where the governments are stable and in full majority. The stable governments are like cushion to the political risk.
- Cordial political relations between the firm‘s home country and the host countries have a direct favourable impact on foreign direct investments (FDIs). As for example, India is having good political relationship with Sri Lanka and Mauritius which led to high level of trade and investment whereas the reverse situation exists in case of Indo-Pak trade. Trade war between China and US is a fresh example, both are imposing trade duties/restrictions on each other, the pressure could be observed in the stock markets of many countries. Strategically, these types of moves hurt business sentiments and generate radical losses in the investments.
- Generally, MNCs like to invest happily in democratic countries like India as democratic countries have good relationships with other countries. MNCs hesitate little a bit in visiting the economies having unfavourable governmental set up and different/unfriendly political environment.
- Protectionism is called as the policy of protecting industries against the foreign competition.

Governments intervene in trade to protect their nation's economy and businesses with the help of tariffs & non-tariff barriers, subsidies, import quotas and currency controls mechanism. Governments have several key policy areas in which they can create rules and regulations in order to control and manage trade, including, tariffs, subsidies, quotas, currency manipulations, antidumping rules, export financing, free-trade zones, and administrative policies.

- In order to balance the political environment, the important issues could be sum up as (i) Ideology of ruling party (ii) Nationalism (iii) Stability in the government policies (iv) International relations between countries

4.2.2 International Legal Environment

Before investment in the foreign market, the companies must be aware about the public and private international laws, regulations and legal system because these can affect the company affairs adversely. Prior knowledge of international law is must because when firms starts business operations abroad, they may face major challenges in facing different laws, regulations, and different legal systems in different international markets. There are chances that the host governments may protect their businesses and rules, regulations, legal system may adversely influences the expansion plans in certain countries. Incomplete knowledge of laws/legal procedures will hamper the legal contracts or trade agreements in the host country.

The basic problem in international legal environment is that the companies are going to face wide variations in the laws, regulations and legal system between countries. One trade practice is considered legal and might be considered unfair in another country. Even standards of the product packaging are different in different countries. As for example, it is mandatory for the companies to follow strictly the provisions of The Cigarettes and Tobacco Products (Packaging and Labelling) Act 2008 and any violation of notification regarding advertising on cigarettes and tobacco products is also punishable offence in India.

4.2.3 International Socio-Cultural Environment

Culture consists of tastes, preferences, choices, attitude, languages, customs, religion, habits, beliefs and values, thought and behavioral patterns of the members of a society. Social factors include reference groups, family, family size, occupation of family members, lifestyle, education system, role and status in the society. A country follows a particular culture in their political boundary is called national culture. A particular culture followed in businesses is called business culture that may guide for everyday business interactions. The philosophies, ideologies, values, assumptions, beliefs, expectations, ethics, principles, attitudes, standards and norms that bind an organization together and are mutually followed by its employees are called organisational culture.

Multinational companies proactively examine the socio-cultural environment before targeting their customers in international market. The cost of ignoring customs, religion, habits, beliefs and values, thought and behavioral patterns of the members of a society could be heavy for companies ready to target their customer in host countries. The buying and consumption habits, language, education system, reference groups, occupation of family members, education system, role and status in the society affect the international business. As for example, education level in the host country affects the company‘s communication strategy in terms of changes in advertising programmes and labeling. For a business to be successful in international market should be the one that is appropriate in the international socio- cultural environment as misunderstanding of the socio-cultural environmental factors could be disastrous.

4.2.4 International Technological Environment

Technological environment have very important implication on international business. The type, level and speed of the new technology are important issues for the companies doing businesses abroad. Advancement of technology like use of robotics, artificial intelligence, automation is helpful in the production system for the companies especially automobile and the multinational companies having mass production in the host countries. Some labour intensive economies believe in old and traditional methods and therefore, use of sophisticated capital intensive technology used in developed countries are not adopted by developing countries. The opposition of the automation and robotics system adversely affect the business.

Advancement of information technology has revolutionized the way organisations conduct businesses abroad. MNCs have further updated international market operations, distribution systems, inventory management, quality control techniques, enterprise resource management, etc., using most effective information technology in international market. E-commerce, internet banking, video-conferencing, webinars, digital investments, online payment, e-wallets, e-learning, e-auction, e-trading, etc., are the new platforms emerged due to evolution of internet. Further, B2B, B2C, B3G, C2C, M-Commerce are some of the different types of e-commerce models emerged due to the contribution of information technology.

4.2.5 International Economic Environment

Economic environment have very important implication on international business. The economic policy, monetary policy, fiscal policy, trade policy, industrial policy, export-import policy, rate of growth, inflation, financial system, balance of payments, savings and investment, fiscal stability are important issues of international economic environment for the companies doing businesses abroad. These factors are different in different countries. The knowledge of international economic environment will help international managers to predict how economic trends and events might affect performance of business abroad. Whenever a company thinks about investment or operations in markets abroad, they should take into consideration the national income, per capita income, distribution of income and stage of economic development as these factors determine the prospects for international business. They must have consideration in their mind about the growth of primary and secondary capital markets, efficiency of public and private sector and size of the international market where the company is going to have strategic decision making. Infrastructure of the host country includes transportation, communication, warehousing, banking, insurance services are very important because if infrastructure facilities are inadequate then the company may hamper its production, marketing, distribution plans in the host country.

4.3 FACTORS CONTRIBUTING TO RAPID GROWTH OF INTERNATIONAL BUSINESS

The buying and selling of goods, and services, across the border is called international business. The companies expand their business activities like manufacturing, mining, transportation, banking, insurance, health, logistics, communication, construction, agricultural etc to expand their business abroad. The companies manage man, material, capital, knowledge, machinery across the border. Companies use geographical expansion as their top level strategy. Sometimes, expansion activities help them to overcome the saturation of the domestic business. The companies will be able to sell their quality products at reasonable prices abroad. In other words, it can be concluded that when business activities are carried across the political borders of a country, it is termed as international business. The factors contributing to rapid growth of international business are listed as below:

- The governments are consistently understanding the importance and taking steps of liberalization of cross-border trade and resource movements.
- Large numbers of countries are liberalizing the economic policies to attract more and more investments.
- There is rapid technological advancement and increase in and expansion of technology throughout the globe.
- There is consistently development of services that support international business.
- There is an emergence of supportive institutions for growth in international business.
- The consumers across the globe are becoming more challenging and growing consumer pressures.
- Increased global competition has led to consistent improvement in business processes which leads to improvements in the standards of the quality of products and services.
- There is a consistent change in political situations and the cooperation is expanded among nations.
- Now-a-days, international business has grown rapidly in current business environment as markets have become global for majority of products and services and especially for financial tools.
- The multinational companies invest in foreign market to acquire natural resources.
- Maximum of multinational companies spend huge amount of funds on R&D. The foreign market is the best option to recover of large expenditure made on research and development.
- In international business, the companies are able to capture a large segment of international market. MNCs earn large profits and improve balance of payment position.
- MNCs work with long term commitment. The strategic decisions are taken by top level management of the MNCs, so the host countries don‘t have to worry as much about foreign companies coming or leaving overnight.

- MNCs help in the economic development and help in resource transfer and market diversification.
- MNCs help in transfer of technology and MNCs increases employment and improve employees‘ efficiency.
- MNCs contribute to corporate tax revenues.
- International business includes not only international trade of goods and services but also foreign investment, especially foreign direct investment (FDI). The developing as well as some emerging economies now understand the importance of FDI for their economies in terms of investments, employment generation, rise in standard of living, technology requirement and up gradation, etc.
- FDI is direct investment in to production in a country by a company in another country, either by buying a company in the target country or expanding operation of an existing business in that country.
- A foreign direct investment can be made by (i) obtaining a lasting interest (obtaining 10% rights in a firm and actively managing as well as influencing company‘s operations or (ii) by expanding one‘s business into a foreign country or (iii) mergers and acquisition or (iv) starting subsidiary in the foreign market.
- Host countries are benefited with the access to management knowledge, expertise and skills.

4.4 CHECK YOUR PROGRESS

1. Capitalism, socialism and Mixed are the types of:

    (A) Economic System

    (B) Social System

    (C) Cultural Attitudes

    (D) Political System

2. Which of the following is not a factor of PESTEL Analysis?

(A) Political

(B) Ecological

(C) Legal

(D) Threats

3. Which of the following is not a factor of political Environment according to PEST analysis?

(A) Government stability

(B) Bureaucracy

(C) Freedom of press

(D) Health consciousness

State whether the following statements are True or False

4. Multi-party democracies, one-party states, constitutional monarchies, dictatorships are the types of political systems.

5. PEST analysis is an analysis of the political, economic, social and technological factors in the external environment of an organisation

6. The demographic and cultural factors of a home and host country are significantly similar

Fill in the Blanks

7. _______________is the process of a government‘s taking ownership of a property without compensation.

8. ______________the total value of all final goods and services produced within a nation in a particular year.

9. If government is taking ownership of a property with some compensation then it is called ___.

4.5 SUMMARY

The companies engaged in international business have to anticipate and analyze the international business environmental. The environment of international business is regarded as the sum total of all the external forces working upon the firm as it goes about its affairs in foreign markets. The foreign environment can be taken as those factors which operate in those other countries within which the MNC operates. The forces are Political Environment, Legal & Regulatory environment, Social & Cultural environment, Technological Environment and Economic environment.

The political environment in international business consists of a set of political factors like political/economical relationships with other country or confrontation between two or more governments, political unrest, violence, labour strike and protests, government activities related with taxation, tariff/non-trariff barriers, economic sanctions etc in a foreign market that can either facilitate or hinder a business' ability to conduct business activities in the foreign market.

The type and structure of government prevailing in a country decides, promotes, fosters, encourages, shelters, directs, and controls the business of that country. Like democracy refers to a political arrangement in which the supreme power is vested to the people, for the people and by the people. Democracies maintain stable business environments primarily through laws protecting individual property rights, gives freedom of speech and generates supportive values as for example India.

A political risk is the risk of sudden change in government policy might be because of change in the political party/government, terrorism, war, sanctions and disagreement between countries that could adversely impact a company ability to operate effectively and profitably.

Generally, the multinational companies (MNCs) like to invest in the countries where the governments are stable and in full majority. The stable governments are like cushion to the political risk. Cordial political relations between the firm‘s home country and the host countries have a direct favourable impact on foreign direct investments (FDIs). Generally, MNCs like to invest happily in democratic countries like India as democratic countries have good relationships with other countries. MNCs hesitate little a bit in visiting the economies having unfavourable governmental set up and different/unfriendly political environment. Protectionism is called as the policy of protecting industries against the foreign competition. Governments intervene in trade to protect their nation‘s economy and businesses with the help of tariffs & non-tariff barriers, subsidies, import quotas and currency controls mechanism. In order to balance the political environment, the important issues could be sum up as (i) Ideology of ruling party (ii) Nationalism (iii) Stability in the government policies (iv) International relations between countries.

Prior knowledge of international laws is must because when firms starts business operations abroad, they may face major challenges in facing different laws, regulations, and different legal systems in different international markets.

Culture consists of tastes, preferences, choices, attitude, languages, customs, religion, habits, beliefs and values, thought and behavioral patterns of the members of a society. Social factors include reference groups, family, family size, occupation of family members, lifestyle, education system, role and status in the society. Multinational companies proactively examine the socio-cultural environment before targeting their customers in international market.

Technological environment have very important implication on international business. The type, level and speed of the new technology are important issues for the companies doing businesses abroad. Advancement of technology like use of robotics, artificial intelligence, automation is helpful in the production system for the companies especially automobile and the multinational companies having mass production in the host countries. Advancement of information technology has revolutionized the way organisations conduct businesses abroad.

Economic environment have very important implication on international business. The economic policy, monetary policy, fiscal policy, trade policy, industrial policy, export-import policy, rate of growth, inflation, financial system, balance of payments, savings and investment, fiscal stability are important issues of international economic environment for the companies doing businesses abroad. These factors are different in different countries.

The factors contributing to rapid growth of international business are related with the governments, rapid technological advancement throughout the globe, development of services that support international business, emergence of supportive institutions, growing consumer pressure, increased global competition, long term commitment of MNCs, transfer of technology, etc.

4.6 KEYWORDS

Culture

Culture can be defined in terms of tastes, preferences, choices, attitude, languages, customs, religion, habits, beliefs and values, thought and behavioral patterns of the members of a society.

4.7 SELF- ASSESSMENT TEST

Q.1 What do you mean by international business environment? Explain the external business environment.

Q.2 International business environment is very uncertain, then why do companies want to engage in international business?

Q.3 Is it important to study the environmental factors of a country before setting up a business over there? Justify your answer.

Q.4 Discuss the special problems related business environment factors that an international company faces in different host countries.

Q. 5 ―Cultural difference is one of the most challenging factors for international business.‖ Comment on the statement.

Q. 6 Explain the main contributing factors for Growth in International Business.

Q. 7 How economic environment affects the international business? Explain with examples.

Q. 8 ―Technology has become very important now a day‖. How technology affects business growth in global world?

Q. 9 Explain the framework for analyzing the international business environment in detail.

Q. 10 What is political environment? What are the political risks faced by global business?

Q. 11 What do you understand by legal environment? How MNCs handle legal issues in host countries?

4.8 ANSWERS TO CHECK YOUR PROGRESS

(1) A	(2) B
(3) D	(4) True
(5)True	(6) False
(7) Confiscation	(8) Gross National Product
(9) Expropriation	

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Theories of International Trade

STRUCTURE

5.0 LEARNING OBJECTIVES

International trade theories are the different theories that explain why countries indulge in international trade. The objective of this chapter is to get the students acquainted with the basic concept, assumptions, evolution, implications and criticism of different trade theories of International Business. Students will learn about the different trade theories that have evolved over the past century and which are most relevant today.

After reading this chapter, students will be able to:

- Describe the assumptions of the different trade theories of international business
- Importance of different trade theories
- Explain implications of different trade theories
- Understand the criticism of different trade theories

5.1 INTERNATIONAL TRADE THEORIES

International trade theories are the different theories that explain why countries indulge in international trade. International trade theories are simply different theories to explain international trade. There are many trade theories that have evolved over the past century and some are relevant today. Here is the explanation of the some of the theories developed over time as explained below:

5.1.0 Theory of Mercantilism

Mercantilism is a trade theory stating that nations should accumulate financial wealth, usually in the form of gold (forget things like living standards or human development) by encouraging exports and discouraging imports. Mercantilism was the dominant theory in Europe during 16th to 19th century. Theory of Mercantilism supports for government regulation of international trade to generate wealth and strengthen national power which is contrary to ‗concept of free trade' given by Adam Smith. According to theory of Mercantilism, a country's wealth is measured by the accumulated reservoir of gold and silver it holds. The theory advocated that countries should export more than they import and emphasis on receiving the value of trade surplus (Export-Import) in the form of gold. Thus, it encourages the accumulation of financial wealth and discourages import. That's why all the country emphasized on enhancing more export than they import.

Even today some countries like Japan, Germany follow this theory to some extent.

Key Points of Theory of Mercantilism: mid-16th century

- A nation's wealth depends on accumulated treasure
- Gold and silver are the currency of trade
- Theory says you should have a trade surplus.
- Maximize export through subsidies.
- Minimize imports through tariffs and quotas

Criticism of Theory of Mercantilism

- The major flaws of the theory are restrictions and impaired growth.
- Mercantilism believes in zero-sum game (Zero-sum game theory that is a gain by one country implies a loss to another country).
- Theory is also criticized because of it being too simple.

5.1.2 Absolute Advantage Theory

Absolute Advantage Theory was given by Adam Smith (Wealth of Nations, 1776) in 17^{th} century. According to this theory a country should produce those goods that it can produce at a cheaper cost than that of other nations and export it and import those goods that it cannot produce at lower cost. In other way, a country should produce only those goods where it is most efficient, and import those goods where it is not efficient.

Assumptions of Absolute Advantage Theory

- Resources fully employed
- Countries primarily interested in profit maximization
- Two countries, two commodities
- Costs of transportation not considered
- Assume that resources can move from domestically but not free to move internationally.

The term Absolute Advantage means being more productive or cost-efficient than another country. Therefore, the country having an absolute advantage can produce a good with lower marginal cost (lesser and cheaper resources, in less time, etc.). For example: two countries, say, India and Sri Lanka having same number of labor units can produce as follows:

Table 4.1: Output per Worker in One Year		
	Car	**Bananas**
India	**5**	**1**
Sri Lanka	**2**	**8**

In this example, India has an absolute advantage in producing bananas (8 to 1) whereas Sri Lanka has an absolute advantage in producing cars (5 to 2). Therefore, India should produce bananas and import cars from Sri Lanka.

Key Points of Absolute Advantage Theory

- Adam Smith gave Absolute Advantage Theory.
- This theory advocated the principle of positive-game (gain by one country does not implies a loss to another country.
- Capability of one country to produce more of a product with the same amount of input than another country.
- This theory assumes there is an absolute balance among nations.
- Climatic conditions, skilled labour and deposits of natural resources contribute to the absolute advantage of a country.
- Trade between countries is, therefore, beneficial because a country should produce only goods where it is most efficient, and trade for those goods where it is not efficient.
- Countries should specialise in the production of goods for which they have an absolute advantage and then trade these goods for the goods traded by other countries.

Implications of the Absolute Advantage Theory

- If a country has an absolute advantage in producing a product there exists a potential for gains from trade.

- The more the country is able to specialise in the production of the goods it produces most efficiently, the greater are its potential gains in national well being.

5.1.3 Theory of Comparative Advantage

David Ricardo gave Theory of Comparative Advantage (Principles of Political Economy) in 1817. The Theory of Absolute Advantage stated that the country should produce the goods in which it is more-efficient and import that good in which it is not cost-efficient. But if a country is efficient in the production of both goods then this theory fails to answer how trade could happen. The answer to this question was provided by David Ricardo, in his theory of international trade, "Comparative Advantage Theory" in 1817, in his book ―Principle of Political Economy‖. A person is said to be having a comparative advantage at producing something if he can produce it at lower cost than anyone else could.

Assumptions of Theory of Comparative Advantage

- This theory considers that all the resources are fully employed.
- Countries primarily are interested in profit maximization.
- Two countries, two commodities are included in this theory.
- Costs of transportation not considered.
- This theory assume that resources can move domestically but not free to move internationally

The theory of comparative advantage states that if a country is efficient in producing those goods where it has a lower opportunity cost, and then there will be an increase in economic welfare. The theory also advocated that a country should import even if it is more efficient in the production of that good than that country from which it is importing, that is if comparatively efficient, than import.

Table 4.2: Comparative Advantage

Country	Cloth	Wine
England	100 men	120 men
China	90 men	80 men

It can be seen from the table that China has absolute advantage in products, cloth and wine. But according to comparative advantage theory, England should import more wine as it requires 120 men to produce it and purchase it by the export of cloth to China. The reason is that to produce the cloth England must require the labour of 100 men to produce the cloth and 120 men to produce wine at the same time.

Difference between Absolute and Comparative advantage

Absolute advantage is concerned with producing at a lower cost whereas comparative advantage emphasis on producing at a lower opportunity cost, relatively better.

Limitations of Theory of Comparative Advantage

- The theory is driven only by maximization of production and consumption.
- Only two countries are engaged in production and consumption of just two goods, it not very realistic.
- The transportation costs are not considered.
- Only resource – labour (that too, non-transferable) is considered in the theory.

5.1.4 Factor Endowments Theory

- Heckscher (1919) and Ohlin (1933) put forward a different explanation of comparative advantage which is called as a Factor Endowments Theory.
- Heckscher-Ohlin theory postulates that countries export those goods that make intensive use of those factors that are locally abundant, while importing goods that make intensive use of factors that are locally scarce.
- The theory says that a country with capital abundance will export capital-intensive goods while the labour-abundant countries will export labour-intensive products.
- Leontief Paradox: (1950) Leontief came out with a finding which almost contradicted this theory (Heckscher-Ohlin theory).
- His research concluded that export require more labour-intensive production than imports.
- In other words, a capital-abundant country cannot export capital –intensive goods.

5.1.5 Product Life Cycle Theory

Product Life Cycle Theory was developed by Raymond Vernon in 1960. He does not agree with the earlier theories based on comparative cost and introduces a new one that emphasis on information, uncertainty and scale economies. The product life-cycle (PLC) refers to the different stages a product goes through its whole life from introduction to its withdrawal from market. It is based on the assumption that:

- country **MAY BE AVAILABLE FOR THE PRODUCTION OF A PARTICULAR PRODUCT BASED ON ITS LIFE-CYCLE** and
- **DURING THE WHOLE LIFE CYCLE OF THE PRODUCT, THE PRODUCTION WILL BE TRANSFERRED TO THE REGIONS THAT IS HAVING BEST CONDITIONS FOR PRODUCTION**

According to this theory, there are four stages in a product's life cycle: **Introduction**, **Growth**, **Maturity** and **Decline**.

The Introduction Stage

When an organization develops a product successfully, it introduces new innovative product in the market. At this stage, the product is new to market; therefore investments are made to create consumer awareness and promotion of the new product. At this stage, profits and sales are low. Exports are either non-existent or in a limited way. When product becomes well known and sales gradually increase, it enters the next stage, i.e., growth stage.

The Growth Stage

In this stage the demand for the product increases in domestic and foreign markets, which results in increased sales. The production costs decrease and high profits are generated. The product becomes well known among the customers, and competitors enter the market. Usually, they offer the product at a much lower sales price. To cope up with competition, the company that developed the original product will still increase its promotional spending.

The Maturity Stage

In the maturity stage, the product is well known and its sale is on peak. The product picks up in consumer acceptance and popularity. Competition is intense and a company does anything to retain its position as market leader. Sometimes, the product is sold at record low prices. Also, the company starts looking for adaptations or innovations to the product and the production of by-products. Near to the end of the maturity stage, attempts are made to produce the product in the developing countries.

Further, consumers are encouraged to replace their current product with a new one. The marketing and promotion costs are therefore very high in this stage.

The Decline Stage

At this stage, the market becomes saturated and the product is no longer demanded due to obsolete technology and introduction of new and innovative products. However, companies continue to offer the product as a service to their loyal customers.

5.1.6 Competitive Advantage

Competitive advantage is a position a firm occupies against its competitors. There are three methods for creating a sustainable competitive advantage are through (i) cost leadership, (ii) differentiation and (iii) focus. The primary factors of competitive advantage are innovation, reputation and relationships. Individual corporations are determined by the extent to which they cope with, and manipulate, the Porter‘s Five Key 'Forces' which make up the industry structure:

a. The bargaining power of suppliers;

b. The bargaining power of buyer;

c. The threat of new entrants;

d. The threat of substitute products; and
e. Rivalry among existing firms.

5.1.7 Limitations of Early Trade Theories

- Early trade theories do not take into account the cost of international transportation.
- Tariffs and import restrictions can distort trade flows.
- Scale of economies can bring about additional efficiencies.
- When governments selectively target certain industries for strategic investment, this may cause trade patterns contrary to theoretical explanations.
- Today, countries can access needed low-cost capital on global markets

5.1.8 New Trade Theory

New Trade Theory (NTT) is an economic theory, developed in the 1970s. Countries produce similar products and still they are trade partners, thus it was developed to understand and predict the trade pattern among countries. US produces car and purchase many cars produced in other countries too. Variety of products and services are available to consumers due to globalization. That is why consumers are more attracted towards brand names rather than the country of origin.

In industries with high fixed costs:

- Specialization increases output, and the ability to enhance economies of scale increases
- Learning effects are high. These are cost savings that come from _learning by doing‘

New Trade Theory – Applications

- Typically, requires industries with high, fixed costs
- World demand will support few competitors
- Competitors may emerge because of ―First-mover advantage‖
- Economies of scale may preclude new entrants
- Role of the government becomes significant
- Some argue that it generates government intervention and strategic trade policy

5.2 CHECK YOUR PROGRESS

1. The Factor Endowments Theory was given by:

(A) David Ricardo (B) Heckscher and Ohlin

(C) Raymond Vernon (D) Michael E. Porter

2. Which of the following theories holds that different countries produce some goods more efficiently than others; therefore, world efficiency can increase through free trade?

(A) Absolute Advantage (B) Comparative Advantage

(C) Factor Endowment (D) Country-Similarity Theory

3. The capacity of a nation to produce more of a good with the same amount of input than another nation is called:

(A) Competitive Advantage (B) Perfect Competition

(C) Absolute Advantage (D) Economies of Scale

4. Which of the following theory was propounded by Raymond Vernon?

(A) International Trade Theory (B) Product Life Cycle Theory

(C) Country-Similarity Theory (D) Theory of Competitive Advantage

5. Which of the following theory is propounded by Paul Krugman?

(A) Factor Proportions Theory (B) New Trade Theory

(C) Product life cycle theory (D) Competitive Theory

6. Which of the following is an assumption of Heckscher-Ohlin theory?

(A) There are no transport costs

(B) Is perfect competition in both commodity and factor markets

(C) All production functions are homogeneous

(D) All of above

Fill in the Blanks

7. ‗Concept of Free Trade' given by________________.

8. If the cost per unit of output depends upon the size of the industry, not upon the size of an individual firm, it is referred to as_____.

9. ___________in his seminal work ―International Investment and International Trade in Product Life Cycle‖ explained that international markets tend to follow a cyclical pattern.

10. Factor Endowment Theory is also called Factor____________Theory.

11. ___________was the first economists to support international trade in his book ―An Inquiry into the Nature and Causes of the Wealth of Nations‖, published in 1776.

State whether the following statements are True or False:

12. As per Ricardo, the exporting country should make only those goods it could produce most efficiently.

13. The theory of absolute advantage is based on Adam Smith‘s doctrine of laissez faire.

14. Only one nations and one commoditie is a assumptions of the Law of Comparative Advantage.

15. The theory of comparative advantage suggests that a country should export goods in the country in which its relative cost advantage

16. David Ricardo propounded a theory of comparative advantage in 1817 his seminal book ―Principles of Political Economy and Taxation‖.

5.3 SUMMARY

International trade theories are the different theories that explain why countries indulge in international trade. There are many trade theories that have evolved over the past century and some are relevant today.

Mercantilism is a trade theory stating that nations should accumulate financial wealth, usually in the form of gold (forget things like living standards or human development) by encouraging exports and discouraging imports. A nation‘s wealth depends on accumulated treasure and gold and silver are the currency of trade. The main criticism of theory of mercantilism is that mercantilism believes in zero- sum game (Zero-sum game theory that is a gain by one country implies a loss to another country).

Absolute Advantage Theory stated that a country should produce those goods that it can produce at a cheaper cost than that of other nations and export it and import those goods that it cannot produce at lower cost. In other way, a country should produce only those goods where it is most efficient, and import those goods where it is not efficient. This theory assumes two countries, two commodities and costs of transportation not considered.

The Theory of Absolute Advantage stated that the country should produce the goods in which it is more-efficient and import that good in which it is not cost-efficient. But if a country is efficient in the production of both goods then this theory fails to answer how trade could happen. This theory assumes two countries, two commodities are included in this theory and costs of transportation not considered.

Absolute advantage is concerned with producing at a lower cost whereas comparative advantage emphasis on producing at a lower opportunity cost, relatively better.

Heckscher-Ohlin theory postulates that countries export those goods that make intensive use of those factors that are locally abundant, while importing goods that make intensive use of factors that are locally scarce. The theory says that a country with capital abundance will export capital-intensive goods while the labour-abundant countries will export labour-intensive products. Leontief Paradox: (1950) Leontief came out with a finding which almost contradicted this theory.

Product Life Cycle Theory introduces a new one that emphasis on information, uncertainty and scale economies. The product life-cycle (PLC) refers to the different stages a product goes through its whole life from introduction to its withdrawal from market. It is based on the assumption that: country **MAY BE AVAILABLE FOR THE PRODUCTION OF A PARTICULAR PRODUCT BASED ON ITS LIFE-CYCLE** and **DURING THE WHOLE LIFE CYCLE OF THE PRODUCT, THE PRODUCTION WILL BE TRANSFERRED TO THE REGIONS THAT IS HAVING BEST CONDITIONS FOR PRODUCTION.**

According to this theory, there are four stages in a product‘s life cycle: **Introduction, Growth**, **Maturity** and **Decline**.

Competitive advantage is a position a firm occupies against its competitors. There are three methods for creating a sustainable competitive advantage are through (i) cost leadership, (ii) differentiation and (iii) focus. The Porter‘s Five Key 'Forces' which make up the industry structure: The bargaining power of suppliers; The bargaining power of buyer; The threat of new entrants; The threat of substitute products; and Rivalry among existing firms.

New Trade Theory (NTT) states that countries produce similar products and still they are trade partners, thus it was developed to understand and predict the trade pattern among countries. US produces car and purchase many cars produced in other countries too. Variety of products and services are available to consumers due to globalization. That is why consumers are more attracted towards brand names rather than the country of origin.

5.4 KEYWORDS

LEONTIEF PARADOX

Leontief contradicted Heckscher-Ohlin theory in1950, called Leontief Paradox

Product Life-cycle

The product life-cycle (PLC) refers to the different stages a product goes through its whole life from introduction to its withdrawal from market.

5.5 SELF- ASSESSMENT TEST

Q.1 Write short notes on: (a) Mercantilism (b) New trade theory

Q.2 Describe the basic assumptions of Adam Smith‘s theory.

Q.3 Is absolute advantage the correct justification for international trade? Validate your answer.

Q.4 Explain the difference between Absolute Advantage and Comparative Advantage. How the theory of Absolute Advantage evolved?

Q.5 Describe the basic assumptions of Factor Endowment theory. How it is different from Ricardian theory?

Q.6 Discuss the implications of trade theories on the present day economic scenario in the international trade.

Q.7 Elaborate the grounds of the early trade theories‘ criticism?

Q.8 Is there any relevance of International Product Lifecycle Theory now-a-days? If yes, why?

Q.9 Enumerate the stages of Product Life cycle in international business.

Q.10 ―Trade Theories provide logical explanations about why nations trade with one another but these theories are limited by their assumptions.‖ Comment on the statement.

5.6 ANSWERS TO CHECK YOUR PROGRESS

1) B	(2) A
(3) C	(4) B
(5) B	(6) D
(7) Adam Smith	(8) External economies of scale.
(9) Vernon Raymond	(10) Proportions
(11) Adam Smith	(12) True
(13) True	(14) False
(15) True	(16) True

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International Organisations & Agreements

STRUCTURE

6.0 Learning Objectives

6.1 Introduction: Multilateral Regulation of Trade and Investment

6.2 Meaning of Multilateral Trade Agreement

6.2.1 International Monetary Fund (IMF)

6.2.2 World Bank

6.2.3 UNCTAD

6.2.4 WTO

6.3 Regional Economic Cooperation

6.3.1 Advantages of Regional Agreements

6.3.2 Disadvantages of Regional Agreements

6.3.3 Major Areas of Regional Economic Integration and Cooperation

6.4 Check Your Progress

6.5 Summary

6.6 Keywords

6.7 Self- Assessment Test

6.8 Answers to Check Your Progress

6.9 References / Suggested Readings

6.0 Learning Objectives

A multilateral trade agreement involves an agreement between two or more countries to conduct trade without any discrimination. The objective of this chapter is to get the students acquainted with the knowledge of IMF, World Bank, WTO, UNCTAD and Regional Economic Cooperation.

After reading this chapter, students will be able to:

- Describe the role, structure, function of World Bank, and IMF,
- Explain the concept of regional economic integration and cooperation
- Learn organisation, function, role of UNCTAD

6.1 Introduction: Multilateral Regulation of Trade and Investment

Investment from foreign investors and countries in the form of foreign direct investments and foreign institutional investments are among the driving forces of for the development of infrastructure especially in the developing countries. Economic development strategies of most countries are now based on attracting multinational companies. International financial markets are easily accessible by the large domestic firms, as well as stable governments. This process is considered positive as it stimulates economic growth in developing countries, also helps in reducing poverty. But the rapid changes in global era clearly create both losers and winners, and it is the responsibility of international regulatory and national authorities to ensure that the economic benefits are maximized and the social costs are minimized.

6.2 Meaning of Multilateral Trade Agreement

A multilateral trade agreement involves an agreement between two or more countries to conduct trade without any discrimination. Multilateral trade agreements reduce trade barriers and increases businesses between member countries. It helps to increase the degree of economic integration between the member countries. Multilateral trade agreements strengthen the global economy and are considered the most practical way of liberalizing trade by taking the benefits of globalisation.

Although multilateral trade existed since the inception of civilization, it was only after World War II that countries recognized the need for a set of rules to secure market access for all countries equally.

Trade and Investment in the multilateral trading system was first considered in the Havana Charter of 1948 that proposed establishment of an International Trade Organization (ITO) to regulate trade relations amongst members; however it was adopted, it did not come into force. Subsequently the General Agreement on Trade and Tariffs (GATT) was maintained to regulate trade relations and as a forum for trade negotiations amongst members, but it did not extend to services and investment. Most of countries were resorted to Bilateral Investment Treaties (BITs) to regulate and protect foreign investments.

Advantages of Multilateralism

- In the age of globalization, the cultures and economies of countries are part of interdependent global economies in such that any events that happen in a country, may impact the other countries too. For this reason signatories of the multilateral agreements treat each other equal.
- Multilateral trade agreements increase trade for each member countries and member countries could share resources & expertise as well. Nations working together can pool these resources and achieve more successful outcomes as well as cost savings.
- In multilateral trade agreements, member countries share standardised commerce regulations, therefore, multinational companies are benefited with the common rules.
- In areas such as economic development and environment, a number of countries acting together can achieve effective results than each country acting alone. Commitment for reducing their greenhouse gas emissions under Kyoto Protocol is the best example of multilateral trade agreements.

Disadvantages

- Multilateral trade agreements are complex and it become difficult for countries as to negotiate easily. Thus, it becomes time consuming process for them.
- Different countries have different priorities and different ideas regarding what actions should be taken, in what order and with what goals. Acting multilaterally can mean compromising on both the timeline and goals of a proposed action.
- In multilateral trade agreements, big multinational companies are benefitted while small scale business/companies cannot compete, the country may face unemployment issues.

- While sharing resources can be beneficial to countries but it can also complicate matters. For example the impact of failure of banks in US in 2008 impacted the economic activities of every country in the world.

It can be said that developing countries get benefitted from membership of a multilateral investment agreement. Many international institutions and agencies have been evolved over the time to regulate multilateral trade and investment among nations.

6.2.1 International Monetary Fund (IMF)

The International Monetary Fund was established in 1945 and the main objective was to promote global economic growth in post-world war era by promoting global trade, global monetary cooperation, secure financial stability, increasing investments, facilitate international trade, bringing stable exchange rates, promote high employment and sustainable economic growth. It has 189 member countries and headquartered in Washington, D.C. In addition to supervising the monetary system, the IMF also serves as an international lender of last resort. Countries having balance-of-payments deficits could finance their deficits by borrowing foreign currencies from the IMF that allows it to repay its sovereign debt on time (from a pool of funds backed by capital contributed by all the member countries).

IMF maintains international monetary cooperation among almost all of the world‘s countries. In periods of peace and relative calm, it regularly analyzes and reviews the economies of all member countries and encourages cooperative and multilateral solutions to problems whereas in times of crisis, it is the first and foremost institution to respond with policy advice and financial assistance.

6.2.1.1 Objectives of International Monetary Fund

The main objectives of IMF, as noted in the Articles of Agreement, are as follows:

- IMF works to foster global growth & economic stability.
- IMF provides policy guidelines and financing help to member countries as and when required.
- To promote international monetary cooperation through a permanent institution that provides the system for consolation and collaboration on international monetary problems.
- IMF helps to shorten the duration and lessen the degree of disequilibrium in the international balance of payments of members and this assistance means to prevent the spread of

international economic crisis.

- To facilitate the expansion and balanced growth of international trade, and thereby to contribute towards the promotion and maintenance of employment and real income.
- To lend loans to low-income countries on concessional terms.
- To promote exchange rate stability and to maintain orderly exchange arrangements among members so as to help member countries to focus on economic growth.
- To assist in the establishment of a multilateral system of payments and in the elimination of foreign exchange restrictions which restrict the growth of trade over global level.
- **"**The IMF‘s financial lifeline provides critical resources for essential healthcare spending and to protect the stability of the economy. The Rapid Financing Instrument also plays a catalytic role for other support.

As for example, like many tourism-dependent countries, Montenegro has been hit hard from the effects of COVID-19. On June 24, 2020, the Balkan country received an emergency loan worth $83.7 million under the IMF‘s Rapid Financing Instrument to help its economy weather the economic disruption caused by the collapse of tourism and to support higher health spending.‖ (Source: https://www.imf.org/)

6.2.1.2 Functions of International Monetary Fund

The primary function of the IMF is to supervise the international monetary system while fulfilling their objectives of granting of loans to member countries facing temporary balance of payments deficits, supervising the monetary and exchange rate policy of member countries and issuing policy recommen- dations.

Regulatory Function:

The fund functions as the guardian by setting a code of rules established through its Articles of Agreement (AOA).

Financial Function:

The primary function of the IMF is to provide temporary financial assistance to its member countries so that _fundamental‘ BOP disequilibrium can be corrected. However, such grant of credit is subject to conditionality, i.e., opening up of the economy by removing all barriers of trade. The conditionality is a form of the IMF‘s surveillance function over the exchange rate policies or adjustment process of member countries. It also functions as an agency of providing resources to meet short term and medium term BOP disequilibrium faced by the member countries.

Consultative Function:

It functions as a centre for international cooperation and a source of technical assistance to its members and also providing consultations. IMF also provides concessional assistance under its poverty reduction and growth facility and debt relief initiatives. It is also providing fund to combat money- laundering and terrorism activities.

Technical Assistance

In addition, technical assistance is also being provided to member countries which cover areas: the designing and implementation of fiscal and monetary policy, the handling and accounting of transactions with the IMF; the collection and retirement of statistical data and training of officials among nations.

6.2.1.3 Organisation of International Monetary Fund

The IMF is an independent agency works with its Executive Board and Board of Governors. **Since its inception, the management of the IMF is done by mainly two bodies:**

(a) Board of Governors and

(b) Board of Executive Directors.

The Board of Governors formulates the general policies and conduct of day to day activities of the IMF are conducted by the Board of Executive Directors. Every member country appoints two governors, one Governor to participate in the meetings of Board of Governors and second, alternate Governor to represent the Governor in respect of its absence. At present, there are 22 members in the Board of Executive Directors, six of which are from USA, UK, Germany, France, Japan and Saudi Arabia and the remaining sixteen directors are elected by other nations. The Managing Director of Board of Directors is elected by the Board of Directors. He is responsible for organisation and management of the Fund.

6.2.1.4 Resources of International Monetary Fund

Quotas are the main source of financing for IMF. Each member of the IMF is assigned a quota, based broadly on its relative position in the world economy. The subscription quota of each member country is determined by its national income and contribution of trade in world trade. Every member nation

contributes 25 per cent of its quota in international reserve assets and the remaining 75 per cent is contributed in member‘s own currency. The contribution of first 25 per cent was made initially in terms of gold but now it is being made in form of Special Drawing Rights (SDRs).

―The most recent increase in quotas, to SDR 477 billion (US$ 651 billion), was agreed under the 14th Review (concluded in December 2010, effective from January 2016.) The 15th Review was concluded in February 2020 without a quota increase. In its resolution concluding the 15th Review, the Board of Governors also provided guidance on the 16th Review, expected to be concluded no later than December 15, 2023.‖

6.2.1.5 Failures of International Monetary Fund:

Despite the fact that IMF has been an important contributor in the global economy still it suffers from failure in many fronts. Following are some of these failures:

(i) IMF provided the loan on the conditional basis subject to the implementation of certain economic policies. The problem of these conditional policies is that of structural adjustment and macroeconomic intervention which make economic situations of borrower countries worse than before.

(ii) The Fund adopts discriminate policy in favour of some countries in its functioning. It is sometimes termed as rich countries club. It provides special treatment to some developed countries while neglecting some backward countries.

(iii) The IMF has also failed to establish a stable and sound international monetary system as world has faced severe monetary crisis many times since its inception. Thus it has failed to bring complete stability in foreign exchange rates as well as the basic objectives of international exchange rate stability. Neither the Fund put any loan exchange fluctuations nor does it prevent competitive devaluation of currencies by its members.

(iv) It is pointed out that the fixation of quota is on unscientific grounds. The rich member countries are maintaining larger quotas and thereby influence the policies and decisions taken by IMF. That‘s why IMF has been branded as Rich Countries Club.

(v) The IMF has also failed to eliminate the multiple exchange rates, trade restrictions with regard to different transactions.

(vi) The IMF has also failed to bring the free convertibility of currency of different countries.

6.2.1.6 Instruments of International Monetary Fund

The IMF Articles of Agreement state that the resources of the Fund are to be used to provide financial assistance to members to meet BOP deficit on current account.

(i) Stand-by Arrangements:

Stand-by Arrangement is the most common way of providing assistance to member countries. The SBA framework allows the Fund to respond flexibly to countries’ external financing needs-and to support their adjustment policies with short-term financing. The term ―stand-by‖ here means that, subject to conditionality, a member has a right to draw the money made available, if needed. Under this arrangement, the length of SBA is flexible, member country obtains the assistance for the period of covering 12-24 months to meet short- term BOP problems. However, it cannot be more than 3 years and repayments are to be made within 3-5 years of each drawing.

“Borrowing Terms: Access to IMF financial resources under SBAs is guided by a member country‘s need for financing, capacity to repay, and track record with use of IMF resources. Within these guidelines, the SBA provides flexibility in terms of the amounts to lend and timing of disbursement. These include:

Normal Access: Borrowing is subject to an annual limit of 145 percent of quota for any 12-month period, and a cumulative limit over the life of the arrangement of up to 435 percent of quota, net of repayments.

Exceptional Access: Access above normal limits is decided on a case-by-case basis under the IMF's Exceptional Access policy.

Front-loaded Access*:* Funds can be front-loaded when warranted by the strength of the country‘s policies and the nature of its financing needs.

Rapid Access: Approval of IMF lending under the SBA can be accelerated under Emergency

Financing Mechanism. This mechanism has been used during the global financial crisis.‖ (Source: https://www.imf.org/)

(ii) Extended Fund Facility (EFF):

Extended Fund Facility is for 3 years but it may be extended for 4 years in some cases. EEF is a facility for the countries experiencing serious Balance of Payment crisis, weak growth or structural impediments. It‘s a common phenomenon for developing countries to suffer from chronic BOP problems which could not always be remedied in the short run. Such BOP difficulties experienced by the poor and developing necessitated an adjustment programme for longer duration. However, conditions for granting loans are very stringent. Borrowing under an EFF is subject to the normal limit of 145 percent annually of a country‘s IMF quota.

(iii) Compensatory Financing Facility (CFF):

Compensatory Financing Facility is for the member countries those having problem of temporary export shortfalls caused by exogenous shocks. Earlier members were allowed to draw up to 25 % of its quota. Now members can draw up to 45 % of their quota.

(iv) Structural Adjustment Facility (SAF) and the Enhanced SAF (ESAF):

This facility was provided in mid-1970s to low income member countries on concessional basis. It was felt that the restrictive and inflexible credit arrangements provided to Least Developed Countries were not adequate to cope with the growing debt problems of the poorest members of the Fund.

―During the SAF's operation, between March 1986 and December 1995, SDR 1.8 billion (about $2.4 billion) was disbursed. Between December 1987 and November 1999, SDR 7.6 billion (about $10.7 billion) was disbursed under 90 ESAF arrangements to 52 countries. Altogether, 56 low-income countries benefited from the IMF's concessional assistance under the SAF and ESAF, affecting nearly one billion people, at least half of whom survived on less than $1 a day.‖ An extended version of SAF, ESAF was introduced in 1987. Later, it was replaced by a new facility, called Poverty Reduction and Growth Facility (PRGF) in 1999.

(v) Poverty Reduction and Growth Facility (PRGF):

The PRGF replaced the ESAF in November 1999 to provide concessional loan to help the poorest and least developed member countries with the objective of making poverty reduction and economic growth. Under these arrangements, least income countries are eligible to borrow up to 140 % of its quota. Rate of interest that is charged is only 0.5% and repayment period covers 5 1/2-10 years, after disbursement of such facility with repayments made semi-annually. PRGF supported programmes focus on strengthening coherence.

(vi) Supplemental Reserve Facility (SRF):

This instrument provides additional short-term assistance to member countries which are facing BOP difficulties due to a large short-term financing need resulting from a sudden and disruptive loss of market confidence. Countries borrowing under the SRF will be expected to repay within one to one and a half years of the date of each disbursement, however, the Board have the authority to extend period of repayment by upto 1 year.

6.2.2 World Bank

World Bank was established in 1944, headquartered in Washington, D.C. with more than 10,000 employees in more than 120 offices worldwide. There are 189 countries in the world as the member of World Bank. The World Bank is an international organization established along with IMF and provides assistance to emerging market countries primarily to reduce poverty and promoting shared prosperity in a sustainable manner. Its primary goal is to end extreme poverty prevailing among member countries. World Bank is working to improve the incomes of the lower 40% of the population in each member country. Since its establishment in 1947, the World Bank has funded more than 12,000 projects. Together with the International Monetary Fund (IMF) and the World Trade Organisation (WTO), it plays a significant role in monitoring economic policies of member countries and reforming public institutions in developing countries and defining the global macroeconomic agenda.

The World Bank is not a bank in the conventional sense of the word. It is a group of institutions consisting of: the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA), and the International Centre for Settlement of Investment Disputes (ICSID).

The IBRD provides loans to middle-income countries and creditworthy lower-income countries at market rates of interest. The IDA was founded in 1960 and it provides interest-free long-term loans, technical assistance, and policy advice to lower income developing countries in areas such as health,

Education, and rural development. The International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA) are collectively known as the World Bank.

6.2.2.1 Purpose and Functions of World Bank

The World Bank Group has set two goals for the world to achieve by 2030: (i) End extreme poverty by decreasing the percentage of people living on less than $1.90 a day to no more than 3% (ii) Promote shared prosperity by fostering the income growth of the bottom 40% for every country‖. (Source: https://www.worldbank.org/)

The World Bank Group is not just only a collection of international agencies with specific missions but it is also a collaborative global institution, with its agencies working collectively towards achieving of the objective of ending extreme poverty and promoting shared prosperity in a sustainable manner. The United States has a controlling voting interest.

The World Bank provides low-interest loans, interest-free credit, and grants to poorer and developing member countries. It mainly focuses on improving education, health, and infrastructure in these countries. It also uses funds to modernize the country's financial sector, agriculture, and natural resources management. It is the vital source of financial and technical assistance to developing nations around the world.

The Bank's stated purpose is to "bridge the economic divide between poor and rich countries." It does this by turning "rich country resources into poor country growth." It has a long-term vision to "achieve sustainable poverty reduction."

The World Bank has also joined the fight against climate change because it could push another 100 million people into poverty by 2030. It is committed to reducing its environmental footprint. It has increased financing towards environmental activities to 28% of its portfolio.

6.2.2.2 Organization of World Bank

The World Bank is like a cooperative, made up of 189 member nations or shareholders. These member nations are represented by Board of Governors. Generally, the governors are member countries' ministers of finance/ministers of development or central bank governors. They meet once in a year in the annual meeting of the World Bank. Board of Governors is the ultimate policymakers of the bank.

The governors delegate duties to a 25-member Board of Executive Directors. The five main contributing countries France, Germany, Japan, the United Kingdom, and the United States appoint an executive director while other member countries countries are represented by elective executive directors. The World Bank president is nominated by the President of the United States. The voting power of the United States is 15.49%, making it the largest shareholder. The World Bank is affiliated with UN, however it is not accountable either to the General Assembly or to the Security Council. The World Bank operates day-to-day under the leadership and direction of the President, management and senior staff, and the Vice Presidents in charge of Global Practices, Cross-Cutting Solutions Areas, regions, and functions.

Voting power is based on a country‘s capital subscription, which is based in turn on its economic resources. The wealthier and more developed countries constitute the bank‘s major shareholders and thus hold more power and influence over the decision-making and policy making of Bank.

The bank has consultative as well as informal ties with the world‘s financial markets and institutions and maintains links with nongovernmental organizations in both developed and developing countries. Many member countries always complain that the bank represents the interests of the developed world and not the poor countries it assists.

6.2.3 Introduction: UNCTAD

The world has become so integrated in the era of globalization that countries have become inter-dependent worldwide resulting in the integration of international markets for a wide range of services and commodities.

The United Nations Conference on Trade and Development (UNCTAD) was established as an organ of United Nations in 1964 as a permanent intergovernmental body dealing with trade, investment, and development issues. It is headquartered in Geneva, Switzerland, and also has offices in New York and Addis Ababa. It reports to UN General Assembly and the Economic and Social Council. It also has its own membership, leadership, and budget. It is also the part of the United Nations Development Group.

6.2.3.1 History of UNCTAD

The increasing influence of developed countries in international trade has led developing countries to call for convening of a full-fledged conference specifically devoted to tackle these problems and identifying appropriate international actions. The first conference of UNCTAD was held in Geneva in 1964. The conference was held to meet every four years. The developing countries established the Group of 77 to voice their concerns and issues.

6.2.3.2 Organization of UNCTAD

The UNCTAD was set up as the permanent body of the United Nations General Assembly. The highest decision and policy-making body of UNCTAD is the Conference. It meets every four years to set policy guidelines for member countries. It has its own structure of subsidiary bodies and a full time secretariat. It consists of a Trade and Development Board. It is responsible for taking policy decisions when the conference is not in session. The Board meets twice a year.

Four subsidiary committees are established to assist the Trade and Development Board, which include:

- The committee on commodities
- The committee on manufacture
- The committee on shipping and
- The committee on invisible items and financing related to trade.

Generally, these committees meet once a year. However, special sessions of committees can be convened to transact matters of urgent nature. All the members of the United Nations are entitled to become the member of the UNCTAD. A special committee furnishes reports from time to time on preferences for the conference to be held.

6.2.3.3 Objectives of UNCTAD

The main objective of UNCTAD is to maximize the benefits of globalization and liberalization for developing and weaker economies. Many pitfalls in international trade such as the loss of autonomy in developing policies at the national level which limits the scope of development policies; the risk of instability and disruptions from other powerful countries resulting from financial openness etc. required the establishment of an institution that can resolve such issues. Therefore, UNCTAD was established:

- To reduce and eventually eliminate the trade gap between the developed and developing Countries,
- To accelerate the rate of economic growth of the developing countries,
- It provides a platform for intergovernmental deliberation over the international trade policies and issues,
- To coordinate and facilitate the activities of the other institutions within the U.N. in the arena of international trade,
- It provides technical assistance customised to the specific needs of developing countries, with special emphasis on the least developed countries and economies in transition.

6.2.3.4 Basic Principles of UNCTAD

The first conference was held in 1964 in Geneva which laid down UNCTAD's action programme and priorities. The various recommendations of the conference are based on the following principles:

1. Every country has the right to freely utilise and dispose of its natural resources for the sake of its economic development. It can freely trade with other countries.
2. Principles of sovereign equality of states, self determination of people and non-interference in the internal affairs are the principles which guide trade and economic relations between countries; and
3. There shall be no discrimination on the basis of differences in socioeconomic systems. The adoption of various trading methods and policies shall be consistent with this principle.

6.2.3.5 Functions of UNCTAD

The essential objective of establishing UNCTAD was to promote accelerated development of the less developed regions and developing countries of the world while dealing with the problem faced by LDCs and developing countries such as slow expansion of exports, persistently increasing BOP deficits, increasing burden of external debts etc.

The main functions of the UNCTAD are as follows:

(i) To promote international trade between the developed and under-developed countries, having diverse socio-economic background and with special emphasis upon the accelerated development of the under-developed and developing countries

(ii) To formulate the principles and policies for international trade

(iii) To take action for implementing the said principles and policies into effect

(iv) To review and facilitate the coordination of activities of other institutions within the United Nations related to international trade and economic development.

(v) To act as a centre that develops trade-related policies for the harmonious working of governments and the regional economic groupings in pursuance of Article 7 of the Charter of the United Nations.

6.2.4 WTO (World Trade Organisation)

After World War II, several international measures were undertaken to liberalise trade and payments between nations. Plans for the creation of a liberal, multilateral system of world trade were started while the war was still in progress. Initiated for the most part by the United States, these plans envisaged a close economic cooperation among the nations in the fields of international trade, payments and investment. International Monetary Fund and International Bank for Reconstruction and Development (World Band) were set up. Similarly, International Trade Organisation (ITO) was sought to set up to deal with the international trade. In 1945, United States were called for convening of a United Nations conference for the purpose of negotiating the international trade charter and for the establishment of an international trade organisation. In December 1945, the US in consultation with UK and Canada prepared a detailed draft trade charter. The suggested Charter was discussed in London during October-November of 1946. There were two major tasks for this discussion. First, was the completion of the draft trade for submission to UN Conference on Trade and Development scheduled for December 1947 in Havana and second, a series of detailed negotiations among the principal countries of the preparatory committee to reduce tariffs and tariff preferences. The results took the form of a tariff schedule for each participating country. These tariff schedules together with those Articles of the Draft Charter that were required to protect the integrity of the trade concessions were combined in an instrument entitled the "*General Agreement on Tariffs and Trade*"-the GATT. All the participants of the preparatory committee signed the Final Act establishing GATT. GATT came into force in 1948 with a membership of 23 industrial countries. By the mid 1980s, its membership had enlarged 90 embracing as many as countries that accounted for over four-fifth of world trade. The ever-expanding group of contracting parties to the GATT, the number of countries joining GATT was 128 when WTO was created. Main activities of GATT may be summarized as: tariff bargaining, bargaining on non-tariff trade barriers, elimination of quantitative restrictions and settlement of disputes between contracting parties. GATT is based on four major provisions: (i) the rules of non-discrimination in trade relations between the contracting countries, (ii) commitment to observe negotiated tariff concessions, (iii) prohibitions against use of quantitative restrictions (quotas) on exports and imports, and (iv) special provisions to promote the trade of developing countries. The remaining provisions of GATT are concerned with exceptions to these general provisions, which include trade measures other than tariffs and quotas, and sundry procedural matters.

Uruguay Round took seven and a half years, almost twice the original schedule. By the end, 125 countries were taking part. It covered almost all trade, from toothbrushes to pleasure boats, from banking to telecommunications, from the plants to AIDS treatments. It was quite simply the largest trade negotiation ever, and most probably the largest negotiation of any kind in history. The seeds of the Uruguay Round were sown in November 1982 at a ministerial meeting of GATT members in Geneva. Although the Ministers intended to launch a major new negotiation, the conference was stalled on the issue of agriculture and was widely regarded as a failure. In fact, the work programme that the Ministers agreed; formed the basis for what was to become the Uruguay Round negotiating agenda. Nevertheless, it took four more years of exploring, clarifying issues and painstaking consensus building, before the Ministers agreed to launch the new round in September 1986, in Punta del Este, (Uruguay). They eventually accepted a negotiating agenda, which covered almost every outstanding trade policy issue. The talks were going to extend the trading system into several new areas, particularly, trade in services and intellectual property, and to reform the trade in the sensitive sectors of agriculture and textiles.

Two years later, in December 1988, ministers met again in Montreal (Canada). The purpose was to clarify the agenda for the remaining two years, but the talks ended in a deadlock that was not resolved until officials met more quietly in Geneva the following April. Despite the difficulty, during the Montreal meeting, Ministers did agree a package of early results. These included some concessions on market access for tropical products-aimed at assisting developing countries, as well as a streamlined, which provided for the first comprehensive, systematic and regular reviews of national trade policies and practices of GATT members. The round was supposed to end when Ministers met once more in Brussels, in December 1990. But they disagreed on how to reform agricultural trade and decided to extend the talks. Despite the poor political outlook, a considerable amount of technical work continued, leading to the first draft of a final legal agreement. The then GATT director general, Mr. Arthur Dunkel, who chaired the negotiations at officials' level, compiled this draft "Final Act". It was placed on the table in Geneva in December 1991. The text fulfilled every part of the Punta del Este mandate, with one exception (it did not contain the participating countries' lists of commitments for cutting the import duties and opening their services markets). The draft became the basis for the final agreement. In November 1992, the EU and US settled most of their differences on agriculture in a deal known informally as the "Blair House accord". By July 1993, the "Quad" (US, EU, Japan and Canada) announced significant progress in negotiations on tariffs and related subjects including market access. On 15 April 1994, the deal was signed by ministers from most of the 125 participating governments at a meeting in Marrakesh (Morocco).

The last round-the Uruguay Round-created a legal institution-the *World Trade Organization* to replace the provisional GATT. The WTO is the only global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by a majority of the world's trading nations and ratified by their Parliaments. The goal is to help the producers of goods and services, the exporters, and the importers conduct their business smoothly.

6.2.4.1 FACT FILE AND FUNCTIONS OF WTO

Location: Geneva, Switzerland

Established: 1 January 1995

Created by: Uruguay Round negotiations (1986-94)

Membership: 148 countries (on 13 October 2004)

Budget: 169 million Swiss francs for 2005

Secretariat staff: 630

Head: Supachai Panitchpakdi (director-general)

FUNCTIONS:

- Administering WTO trade agreements
- Forum for trade negotiations
- Handling trade disputes
- Monitoring national trade policies
- Technical assistance and training for developing countries
- Cooperation with other international organizations

The WTO's main functions are to do with trade negotiations and the enforcement of negotiated multilateral trade rules (including dispute settlement). Special focus is given to four particular policies supporting these functions:

- Assisting developing and transition economies
- Specialized help for export promotion
- Cooperation in global economic policy-making
- Routine notifications when members introduce new trade measure or alter old ones.

6.2.4.2 ASSISTING DEVELOPING AND TRANSITION ECONOMIES

Developing countries make up about three quarters of the total WTO membership. Together with countries currently in the process of "transition" to market-based economies, they play an increasingly important role in the WTO. Therefore, much attention is paid to the special needs and problems of developing and transition economies. The WTO Secretariat's Training and Technical Cooperation Institute organizes a number of programmes to explain how the system works and to help train government officials and negotiators. Some of the events are in Geneva, others are held in the countries concerned. A number of the programmes are organized jointly with other international organizations. Some take the form of training courses. In other cases individual assistance might be offered. The subjects can be anything from help in dealing with negotiations to join the WTO and implementing WTO commitments to guidance in participating effectively in multilateral negotiations. Developing countries, especially the least developed among them, is helped with trade and tariff data relating to their own export interests and to their participation in WTO bodies.

6.2.4.3 SPECIALIZED HELP FOR EXPORTING: THE INTERNATIONAL TRADE CENTRE

GATT established the International Trade Centre in 1964 at the request of the developing countries to help them promote their exports. It is jointly operated by the WTO and the United Nations, the latter acting through UNCTAD (the UN Conference on Trade and Development). The centre responds to requests from developing countries for assistance in formulating and implementing export promotion programmes as well as import operations and techniques. It provides information and advice on export markets and marketing techniques. It assists in establishing export promotion and marketing services, and in training personnel required for these services. The centre's help is freely available to the least-developed countries.

6.2.4.4 THE WTO IN GLOBAL ECONOMIC POLICY-MAKING

An important aspect of the WTO's mandate is to cooperate with the International Monetary Fund, the World Bank and other multilateral institutions to achieve greater coherence in global economic policy-making. A separate Ministerial Declaration was adopted at the Marrakesh Ministerial Meeting in April 1994 to underscore this objective. The declaration envisages an increased contribution by the WTO to achieving greater coherence in global economic policy-making. It recognizes that different aspects of economic policy are linked, and it calls on the WTO to develop its cooperation with the international organizations responsible for monetary and financial matters - the World Bank and the International Monetary Fund. The declaration also recognizes the contribution that trade liberalization makes to the growth and development of national economies. It says this is an increasingly important component in the success of the economic adjustment programmes, which many WTO members are undertaking, even though it may often involve significant social costs during the transition.

6.2.4.5 TRANSPARENCY

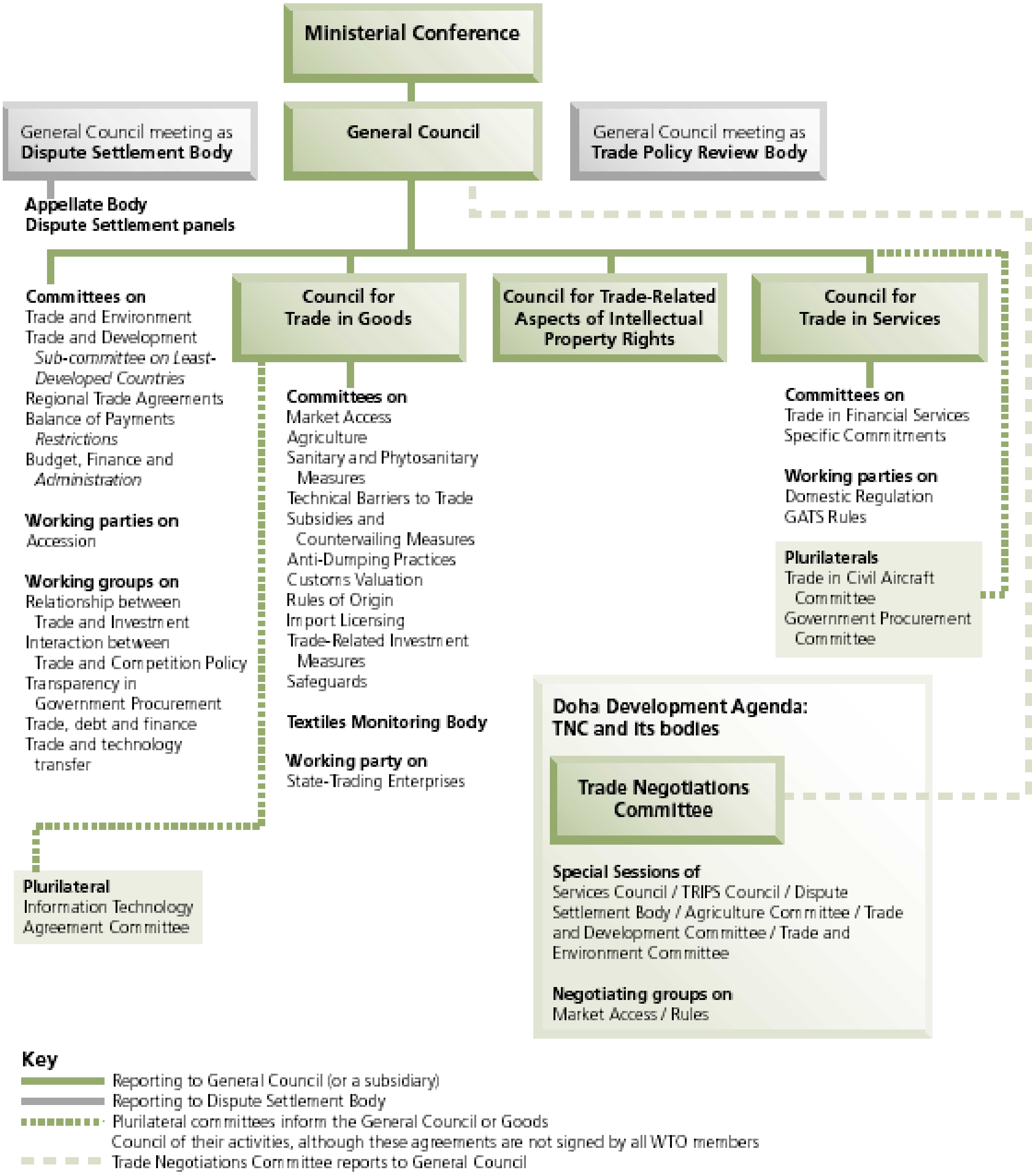
- **Keeping the WTO informed:** Often the only way to monitor whether commitments are being implemented fully is by requiring countries to notify the WTO promptly when they take relevant actions. Many WTO agreements say member governments have to notify the WTO Secretariat of new or modified trade measures. For example, details of any new antidumping or countervailing legislation, new technical standards affecting trade, changes to regulations affecting trade in services, and laws or regulations concerning the intellectual property agreement - they all have to be notified to the appropriate body of the WTO. Special groups are also established to examine new free trade arrangements and the trade policies of countries joining as new members.

- **Keeping the public informed:** The main public access to the WTO is the website, *www.wto.org*. News of the latest developments is published daily. Background information and explanations of a wide range of issues- including “Understanding the WTO”- are also available. And those wanting to follow the nitty-gritty of WTO work can consult or download an ever-increasing number of official documents, now over 150,000, in Documents Online. On 14 May 2002, the General Council decided to make more documents available to the public as soon as they are circulated. It also decided that the minority of documents that are restricted should be made public more quickly - after about two months, instead of the previous six. This was the second major decision on transparency. On 18 July 1996, the General Council had agreed to make more information about WTO activities available publicly and decided that public information, including derestricted WTO documents, would be accessible on-line. The objective is to make more information available to the public. An important channel is through the media, with regular briefings on all major meetings for journalists in Geneva — and increasingly by email and other means for journalists around the world. Meanwhile, over the years, the WTO Secretariat has enhanced its dialogue with civil society - non-governmental organizations (NGOs) interested in the WTO, parliamentarians, students, academics, and other groups. In the run-up to the Doha Ministerial Conference in 2001, WTO members proposed and agreed on several new activities involving NGOs. In 2002, the WTO Secretariat increased the number of briefings for NGOs on all major WTO meetings and began listing the briefing schedules on its website. NGOs are also regularly invited to the WTO to present their recent policy research and analysis directly to member governments. A monthly list of NGO position papers received by the Secretariat is compiled and circulated for the information of member governments. A monthly electronic news bulletin is also available to NGOs, enabling access to publicly available WTO information.

6.2.4.6 WTO STRUCTURE

All WTO members may participate in all councils, committees, etc, except Appellate Body, Dispute Settlement panels, Textiles Monitoring Body, and plurilateral committees (see Graphics 2.1).

Graphics: 2.1



The General Council also meets as the Trade Policy Review Body and Dispute Settlement Body

Source: *www.wto.org*.

The **Services Council's** subsidiary bodies deal with financial services, domestic regulations, GATS rules and specific commitments. At the General Council level, the **Dispute Settlement Body** also has two subsidiaries: the dispute settlement "panels" of experts appointed to adjudicate on unresolved disputes, and the Appellate Body that deals with appeals.

Important breakthroughs are rarely made in formal meetings of these bodies, least of all in the higher-level councils. Since decisions are made by consensus, without voting, informal consultations within the WTO play a vital role in bringing a vastly diverse membership round to an agreement. One step away from the formal meetings is informal meetings that still include the full membership, such as those of the Heads of Delegations (HOD). More difficult issues have to be thrashed out in smaller groups. A common recent practice is for the chairperson of a negotiating group to attempt to forge a compromise by holding consultations with delegations individually, in twos or threes, or in groups of 20–30 of the most interested delegations. These smaller meetings have to be handled sensitively. The key is to ensure that everyone is kept informed about what is going on (the process must be "transparent") even if they are not in a particular consultation or meeting, and that they have an opportunity to participate or provide input (it must be "inclusive"). One term has become controversial, but more among some outside observers than among delegations. The "Green Room" is a phrase taken from the informal name of the director-general's conference room. It is used to refer to meetings of 20–40 delegations. These meetings can be called by a committee chairperson as well as the director-general, and can take place elsewhere, such as at Ministerial Conferences. In the past delegations have sometimes felt that Green Room meetings could lead to compromises being struck behind their backs. So, extra efforts are made to ensure that the process is handled correctly, with regular reports back to the full membership. In the end, decisions have to be taken by all members and by consensus. No one has been able to find an alternative way of achieving consensus on difficult issues, because it is virtually impossible for members to change their positions voluntarily in meetings of the full membership. Market access negotiations also involve small groups, but for a completely different reason. The final outcome is a multilateral package of individual countries' commitments, but those commitments are the result of numerous bilateral, informal bargaining sessions, which depend on individual countries' interests. (Examples include the traditional tariff negotiations, and market access talks in services.) So, informal consultations in various forms play a vital role in allowing consensus to be reached, but they do not appear in organization charts, precisely because they are informal. They are not separate from the formal meetings, however. They are necessary for making formal decisions in the councils and committees. Nor are the formal meetings unimportant. They are the forums for exchanging views, putting countries' positions on the record, and ultimately for confirming decisions. The art of achieving agreement among all WTO members is to strike an appropriate balance, so that a breakthrough achieved among only a few countries can be acceptable to the rest of the membership. Same people, different hats? No, not exactly. Formally, all of these councils and committees consist of the full membership of the WTO. But that does not mean they are the same, or that the distinctions are purely bureaucratic. In practice the people participating in the various councils and committees are different because different levels of seniority and different areas of expertise are needed. Heads of missions in Geneva (usually ambassadors) normally represent their countries at the General Council level. Some of the committees can be highly specialized and sometimes governments send expert officials from their capital cities to participate in these meetings. Even at the level of the Goods, Services and TRIPS councils, many delegations assign different officials to cover the different meetings.

6.2.4.7 WORKING OF WTO

The WTO is run by its member governments. All major decisions are made by the membership as a whole, either by ministers (who meet at least once every two years) or by their ambassadors or delegates (who meet regularly in Geneva). Decisions are normally taken by consensus. In this respect, the WTO is different from some other international organizations such as the World Bank and International Monetary Fund. In the WTO, power is not delegated to a board of directors or the organization's head. When WTO rules impose disciplines on countries' policies, that is the outcome of negotiations among WTO members. The members themselves under agreed procedures that they negotiated, including the possibility of trade sanctions, enforce the rules. But those sanctions are imposed by member countries, and authorized by the membership as a whole. This is quite different from other agencies whose bureaucracies can, for example, influence a country's policy by threatening to withhold credit. Reaching decisions by consensus among some 150 members can be difficult. Its main advantage is that decisions made this way are more acceptable to all members. And despite the difficulty, some remarkable agreements have been reached. Nevertheless, proposals for the creation of a smaller executive body - perhaps like a board of directors each representing different groups of countries - are heard periodically. But for now, the WTO is a member-driven, consensus-based organization.

The WTO continues GATT's tradition of making decisions not by voting but by consensus. This allows all members to ensure their interests are properly considered even though, on occasion, they may decide to join a consensus in the overall interests of the multilateral trading system. Where consensus is not possible, the WTO agreement allows for voting - a vote being won with a majority of the votes cast and on the basis of "one country, one vote". The WTO Agreement envisages four specific situations involving voting:

- An interpretation of any of the multilateral trade agreements can be adopted by a majority of three quarters of WTO members.
- The Ministerial Conference can waive an obligation imposed on a particular member by a multilateral agreement, also through a three-quarters majority.
- Decisions to amend provisions of the multilateral agreements can be adopted through approval either by all members or by a two-thirds majority depending on the nature of the provision concerned. But the amendments only take effect for those WTO members, which accept them.
- A decision to admit a new member is taken by a two-thirds majority in the Ministerial Conference, or the General Council in between conferences.

▪ **Highest authority: the Ministerial Conference:** So, the WTO belongs to its members. The countries make their decisions through various councils and committees, whose membership consists of all WTO members. Topmost is the ministerial conference, which has to meet at least once every two years. The Ministerial Conference can take decisions on all matters under any of the multilateral trade agreements.

- **Second level: General Council in three guises:** Day-to-day work in between the ministerial conferences is handled by three bodies:
  - The General Council
  - The Dispute Settlement Body
  - The Trade Policy Review Body

  All three are in fact the same - the Agreement Establishing the WTO states they are all the General Council, although they meet under different terms of reference. Again, all three consist of all WTO members. They report to the Ministerial Conference. The General Council acts on behalf of the Ministerial Conference on all WTO affairs. It meets as the Dispute Settlement Body and the Trade Policy Review Body to oversee procedures for settling disputes between members and to analyze members' trade policies.

- **Third level: councils for each broad area of trade, and more:** Three more councils, each handling a different broad area of trade, report to the General Council:
  - The Council for Trade in Goods (**Goods Council**)
  - The Council for Trade in Services (**Services Council**)
  - The Council for Trade-Related Aspects of Intellectual Property Rights (**TRIPS Counci**l)

    As their names indicate, the three are responsible for the workings of the WTO agreements dealing with their respective areas of trade. Again they consist of all WTO members. The three also have subsidiary bodies. Six other bodies report to the General Council. The scope of their coverage is smaller, so they are "committees". But they still consist of all WTO members. They cover issues such as trade and development, the environment, regional trading arrangements, and administrative issues. The Singapore Ministerial Conference in December 1996 decided to create new working groups to look at investment and competition policy, transparency in government procurement, and trade facilitation. Two more subsidiary bodies dealing with the plurilateral agreements (which are not signed by all WTO members) keep the General Council informed of their activities regularly.

Fourth level: down to the nitty-gritty: Each of the higher-level councils has subsidiary bodies. The **Goods Council** has 11 committees dealing with specific subjects (such as agriculture, market access, subsidies, anti-dumping measures and so on). Again, these consist of all member countries. Also reporting to the Goods Council is the Textiles Monitoring Body, which consists of a chairman and 10 members acting in their personal capacities, and groups dealing with notifications (governments informing the WTO about current and new policies or measures) and state trading enterprises.

6.2.4.8 MEMBERSHIP, ALLIANCES AND BUREAUCRACY

All members have joined the system as a result of negotiation and therefore membership means a balance of rights and obligations. They enjoy the privileges that other member countries give to them and the security that the trading rules provide. In return, they had to make commitments to open their markets and to abide by the rules — those commitments were the result of the membership (or "accession") negotiations. Countries negotiating membership are WTO "observers". Any state or customs territory having full autonomy in the conduct of its trade policies may join ("accede to") the WTO, but WTO members must agree on the terms. Broadly speaking the application goes through four stages: **Firstly,** The government applying for membership has to describe all aspects of its trade and economic policies that have a bearing on WTO agreements. This is submitted to the WTO in a memorandum, which is examined by the working party dealing with the country's application. These working parties are open to all WTO members; **Secondly, w**hen the working party has made sufficient progress on principles and policies, parallel bilateral talks begin between the prospective new member and individual countries. They are bilateral because different countries have different trading interests. These talks cover tariff rates and specific market access commitments, and other policies in goods and services. The new member's commitments are to apply equally to all WTO members under normal non-discrimination rules, even though they are negotiated bilaterally. In other words, the talks determine the benefits (in the form of export opportunities and guarantees) other WTO members can expect when the new member joins. (The talks can be highly complicated. It has been said that in some cases the negotiations are almost as large as an entire round of multilateral trade negotiations.); **Thirdly**, once the working party has completed its examination of the applicant's trade regime, and the parallel bilateral market access negotiations are complete, the working party finalizes the terms of accession. These appear in a report, a draft membership treaty ("protocol of accession") and lists ("schedules") of the member-to-be's commitments. **Finally,** the package, consisting of the report, protocol and lists of commitments, is presented to the WTO General Council or the Ministerial Conference. If a two-thirds majority of WTO members vote in favour, the applicant is free to sign the protocol and to accede to the organization. In many cases, the country's own parliament or legislature has to ratify the agreement before membership is complete.

Representatives of member governments undertake the work of the WTO, but its roots lie in the everyday activity of industry and commerce. Trade policies and negotiating positions are prepared in capitals, usually taking into account advice from private firms, business organizations, farmers, consumers and other interest groups. Most countries have a diplomatic mission in Geneva, sometimes headed by a special ambassador to the WTO. Officials from the missions attend meetings of the many councils, committees, working parties and negotiating groups at WTO headquarters. Sometimes expert representatives are sent directly from capitals to put forward their governments' views on specific questions.

Increasingly, countries are getting together to form groups and alliances in the WTO. In some cases they even speak with one voice using a single spokesman or negotiating team. This is partly the natural result of economic integration — more customs unions, free trade areas and common markets are being set up around the world. It is also seen as a means for smaller countries to increase their bargaining power in negotiations with their larger trading partners. Sometimes when groups of countries adopt common positions consensus can be reached more easily. Sometimes the groups are specifically created to compromise and break a deadlock rather than to stick to a common position. But there are no hard and fast rules about the impact of groupings in the WTO. The largest and most comprehensive group is the **European Union** (for legal reasons known officially as the **"European Communities"** in WTO business) and its 15 member states. The EU is a customs union with a single external trade policy and tariff. While the member states coordinate their position in Brussels and Geneva, the European Commission alone speaks for the EU at almost all WTO meetings. The EU is a WTO member in its own right as are each of its member states.

A lesser degree of economic integration has so far been achieved by WTO members in the **Association of South East Asian Nations (ASEAN) -** Brunei Darussalam, Indonesia, Malaysia, Myanmar, Philippines, Thailand and Singapore. (The three remaining members, Cambodia, Laos and Viet Nam, are applying to join the WTO.) Nevertheless, they have many common trade interests and are frequently able to coordinate positions and to speak with a single voice. The role of spokesman rotates among ASEAN members and can be shared out according to topic. **MERCOSUR, the Southern Common Market** (Argentina, Brazil, Paraguay and Uruguay, with Bolivia and Chile as associate members), has a similar set-up.

More recent efforts at regional economic integration have not yet reached the point where their constituents frequently have a single spokesman on WTO issues. An example is the **North American Free Trade Agreement: NAFTA** (Canada, US and Mexico). Among other groupings which occasionally present unified statements are the **African Group**, the **least-developed countries**, **the African, Caribbean and Pacific Group (ACP) and the Latin American Economic System (SELA)**.

A well-known alliance of a different kind is the **Cairns Group**. It was set up just before the Uruguay Round began in 1986 to argue for agricultural trade liberalization. The group became an important third force in the farm talks and remains in operation. Its members are diverse, but sharing a common objective - that agriculture has to be liberalized — and the common view that they lack the resources to compete with larger countries in domestic and export subsidies.

The Cairns Group from four continents, members ranging from OECD countries to the least developed: Argentina, Australia, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Guatemala, Indonesia, Malaysia, New Zealand, Paraguay, Philippines, South Africa, Thailand, and Uruguay

6.3 REGIONAL ECONOMIC COOPERATION

Since the inception of civilizations, different forms of trade have been in existence. From ancient past whether any routes for trade have been used, trade and commerce have played a vital role in business expansion. Recent era has witnessed the birth of a global economy. All Countries in the world are today engaged in some form of global trade. Many countries are forming regional free trade bloc or alliance to take advantage of collective and coordinative trade and financial and economic activities. Two famous trade blocs are the European Union (EU) and the North American Free Trade Agreement. These two blocs are creating huge spheres of influence for their member countries.

- Regional trading blocs provide countries with the ability to exchange goods with member countries with minimum or no tariffs or cumbersome trade regulations. It provides for economic cooperation like in a free-trade area.
- In regional trading blocs, restrictions on the movement of labor and capital are removed between member countries.
- Regional trading blocs provide common market. The enhanced integration allows for the creation of economically integrated markets between member countries.
- Regional trading blocs reduce political tensions between countries as well as enhanced globalization of production processes and increased vertical integration.
- Regional trading blocs help in transfer of technology and manufacturing between member countries.
- Regional cooperation in regional trading blocs enhances economic development and providing economic security within the regions.

Economic Union

This type is created when countries enter into an economic agreement to remove barriers to trade and adopt common economic policies. An example is the European Union (EU). In the past decade, there has been an increase in these trading blocs with more than one hundred agreements in place and more in discussion. A trade bloc is basically a free-trade zone, or near-free-trade zone, formed by one or more tax, tariff, and trade agreements between two or more countries. Some trading blocs have resulted in agreements that have been more substantive than others in creating economic cooperation. There are pros and cons for creating regional agreements.

6.3.1 Advantages of Regional Agreements

The pros of creating regional agreements include the following:

- **Trade creation.** These agreements create more opportunities for countries to trade with one another by removing the barriers to trade and investment. Due to a reduction or removal of tariffs, cooperation results in cheaper prices for consumers in the bloc countries. Studies indicate that regional economic integration significantly contributes to the relatively high growth rates in the less-developed countries.
- **Employment opportunities.** By removing restrictions on labor movement, economic integration can help expand job opportunities.
- **Consensus and cooperation.** Member nations may find it easier to agree with smaller numbers of countries. Regional understanding and similarities may also facilitate closer political cooperation.

6.3.2 Disadvantages of Regional Agreements

The cons involved in creating regional agreements include the following:

- **Trade diversion.** The negative side to trade creation is trade diversion. Member countries may trade more with each other than with nonmember nations. This may mean increased trade with a less efficient or more expensive producer because it is in a member country. In this sense, weaker companies can be protected inadvertently with the bloc agreement acting as a trade barrier. In essence, regional agreements have formed new trade barriers with countries outside of the trading bloc.
- **Employment shifts and reductions.** Countries may move production to cheaper labor markets in member countries. Similarly, workers may move to gain access to better jobs and wages. Sudden shifts in employment can tax the resources of member countries.
- **Loss of national sovereignty.** With each new round of discussions and agreements within a regional bloc, nations may find that they have to give up more of their political and economic rights.

6.3.3 Major Areas of Regional Economic Integration and Cooperation

North American Free Trade Agreement (NAFTA)

Brief History and Purpose

The North American Free Trade Agreement (NAFTA) was implemented among U.S., Canada, and Mexico in 1994. The major objective of NAFTA has been to encourage trade between Canada, the United States, and Mexico. Initially, United States and Canada were the members of the Free Trade Agreement in 1988. Canada finally signed in 1992 and become the member of NAFTA. The agreement, which eliminated most tariffs on trade between the three countries, went into effect on January 1, 1994. In the hope to create a free-trade zone where companies can benefit from the transfer of goods, numerous tariffs and trade barriers, particularly those related to agriculture, textiles, and automobiles, were gradually phased out between January 1, 1994 and January 1, 2008.

President Trump made a campaign to repeal NAFTA, and in August 2018, he announced a new trade deal with Mexico to replace it. In September 2018, Canada joined the deal called the United States- Mexico-Canada Agreement (USMCA). In April 2020, Canada and Mexico notified the U.S. that they were ready to implement the agreement.

The European Union (EU)

Brief History and Purpose

The European Union (EU) is the most integrated form of economic cooperation. It eliminates all border controls between members. The EU has developed as a single market through a standardised common laws that apply in all member states. European Economic Community (EEC) was established between the members in 1957. The six nations signed the Treaty of Rome for a common cause. Nine more

members were added in next fifty years. EEC became European Community (EC) in the 1970s and the European Union (EU) in 1993.

The European Union is a unified trade and monetary body of 27 member countries.Its 27 member countries are Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, and Sweden. The EU was formed with three main objectives:

- Single Common currency: Single common currency came into effect in 1999. The Euro is the common currency for the EU area. After the U.S. dollar, it is the second most commonly held currency in the world. The value of the euro is free-floating and the most widely-watched value against US Dollar.
- Common monetary and fiscal policy .
- Common foreign & defense policy and common citizenship.

The European Economic Area (EEA) was established on January 1, 1994, following an agreement between the member states of the European Free Trade Association (EFTA) and the EC (later the EU). Specifically, it has allowed Iceland (now an EU candidate), Liechtenstein, and Norway to participate in the EU‘s single market without a conventional EU membership. Switzerland has also chosen to not join the EU, although it is part of similar bilateral agreements.

6.4 Check Your Progress

1. Which of the following organization issue The Global Competitiveness Index?

(A) United Nations (B) World Economic Forum

(C) World Trade Organisation (D) World Bank

2. FDI involves the transfer of:

(A) Capital only (B) Technology only

(C) Both capital and technology (D) Knowledge and skills

3. The main objective of International Monetary Fund (IMF) was to:

(A) Promote international trade (B) Help economically backward countries

(C) Maintain stable exchange rates (D) Promote international liquidity

4. NAFTA is an example of:

(A) Common Market (B) Customs Union

(C) Economic Community (D) Free Trade Area

5. Which Institution is known as the _soft loan window‘ of the World Bank ?

(A) IMF (B) IFC

(C) IDA (D) None of the above

6. The World Bank is known as:

(A) IMF (B) IDA

(C) IFC (D) IBRD

7. Which of the following is the basic objective of the World Bank?

(A) To provide social services (B) To provide financial assistance

(C) To promote economic growth (D) To eradicate poverty

8. Which of the following is not related to WTO

(A) Trade-Related Investment Measures (TRIMS)

(B) Trade-Related Global Measures (TRGMS)

(C) Trade Policy Review Mechanism (TPRM)

(D) General Agreement on Trade in Services (GATS)

Fill in the blanks:

9. NAFTA is an agreement between USA, Mexico and ....
10. ASEAN was established on August 8, 1967 in ....
11. North American Free Trade Agreement (NAFTA) is a example of--------------------
12. United Nations Conference on Trade and Development came to be existence on 30th December, - --.
13. The International Monetary Fund was established in -------
14. Any reduction in the level of protection of one member country has to be matched by an equivalent reduction in the level of protection given to the other country is called ------ --.
15. According to Agreement on Agriculture (AOA) of WTO Measures with minimal impact on trade can be used freely – they are in a --.
16. Measures required to limit production is called ---------- --.
17. Criteria used to define where a product was made is called ---------- --.

State whether the following statements are true or false:

18. International Centre for the Settlement of Investment Disputes (ICSID) was established in 1966
19. MIGA provides non-commercial guarantees (insurance) for foreign direct investment in developing countries.
20. International Development Associations (IDA provide assistance on concessional loan to the developed countries.
21. The main objective of International Finance Corporation is to strengthen the private sector in developing countries.

6.5 Summary

A multilateral trade agreement involves an agreement between two or more countries to conduct trade without any discrimination.

The International Monetary Fund was established in 1945. IMF maintains international monetary cooperation among almost all of the world‘s countries. The functions of the IMF are to supervise the international monetary system: Regulatory Function, Financial Function, Consultative Function, and Technical Assistance.

The IMF is an independent agency. The management of the IMF is formally accountable to member countries through its Executive Board and Board of Governors. The head office of IMF is located at

Washington, USA. Initially, the IMF had 30 countries as its members. **Since its inception, the management of the IMF is done by mainly two bodies:** (a) Board of Governors and (b) Board of Executive Directors.

The subscription quota of each member country is determined by its national income and contribution of trade in world trade. The contribution of first 25 per cent was made initially in terms of gold but now it is being made in form of Special Drawing Rights (SDRs.

Instruments of **International Monetary Fund are** (i) Stand-by Arrangements (ii) Extended Fund Facility (EFF) (iii) Compensatory Financing Facility (CFF) (iv) Structural Adjustment Facility (SAF) and the Enhanced SAF (ESAF) (v) Poverty Reduction and Growth Facility (PRGF) and (vi) Supplemental Reserve Facility (SRF).

The World Bank is not a bank in the conventional sense of the word. It is a group of institutions consisting of: the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA), and the International Centre for Settlement of Investment Disputes (ICSID). The Bank focuses on several areas to overcome poverty by increasing growth, helps in reconstructing economies destroyed from war, the biggest cause of extreme poverty, spur governments to prevent climate change and work with partners to bring an end to AIDS.

The World Bank is chaired by President. The World Bank president reports to a 25-member Board of Executive Directors. Among the contributing countries are France, Germany, Japan, the United Kingdom, and the United States.

The UNCTAD was set up as the permanent organ of the UN General Assembly. It has established a Trade and Development Board to take policy decisions when the conference is not in session. The Board meets twice a year. There are four subsidiary committees to assist the Trade and Development Board. These include the committee on commodities, the committee on manufacture, the committee on shipping and the committee on invisible items and financing related to trade.

The important functions of UNCTAD are as follows: To promote international trade between the developed and underdeveloped countries, Role of UNCTAD is to 1. Providing a forum for intergovernmental deliberations, 2. Undertaking research, policy analysis and data collection, and 3. Providing technical assistance to developing countries.

Regional trading blocs provide countries with the ability to exchange goods with member countries with minimum or no tariffs or cumbersome trade regulations. Regional trading blocs provide benefits of **Free Trade Area, Customs Union, and Common Market.**

The pros of creating regional agreements include the following: **Trade creation, Employment opportunities, and Consensus and cooperation.**

The cons involved in creating regional agreements include the following: **Trade diversion, Employment shifts and reductions, and Loss of national sovereignty.**

6.6 Keywords

Multilateral Trade Agreement

A multilateral trade agreement involves an agreement between two or more countries to conduct trade without any discrimination resulting in lowering trade barriers & liberalizing trade to increase the degree of economic integration between the member countries to make an interdependent global economy.

Special Drawing Rights

Special drawing rights (SDR) refer to an international type of monetary reserve currency as supplementary foreign exchange reserve assets defined and maintained by the International Monetary Fund (IMF). SDRs are units of account for the IMF, and not a currency per se. They represent a claim to currency held by IMF member countries for which they may be exchanged.

6.7 Self- Assessment Test

Q.1 Describe the basic idea behind introducing GATT.

Q.2 How and when was WTO established? How a new country can join WTO?

Q.3 Explain the concept of Most Favoured Nation‘.

Q.4 Elaborate the structure of WTO in detail.

Q.5 What is dumping? What is WTO‘s stand on dumping?

Q.6 Discuss the positive and negative impacts of WTO on India.

Q.7 Write a short notes on (i) Extended Fund Facility (EFF) (ii) Structural Adjustment Facility (SAF)

Q.8 Explain the origin, objectives and functions of the World Bank.

Q.9 Discuss the objectives of establishing the International Development Corporation.

Q.10 Elaborate the functions of UNCTAD. Explain its basic principles.

Q.11 What are the achievements of UNCTAD? Also explain the problems of UNCTAD.

Q.12 Enumerate the objectives of establishing the International Finance Corporation.

Q.13 What is regional economic integration? Explain the stages of regional economic integration.

Q.14 Explain the advantages and disadvantage of regional trading blocs.

Q.15 Why was IMF established? Discuss the current activities of the IMF.

Q.16 Write short note on: (a) ASEAN (b) NAFTA (c) European Union

Q.17 What are the differences between GATT and WTO?

Q.18 Explain the dispute settlement process of WTO.

Q.19 Write a note on following agreements of WTO:

(a) Agreement on Non tariff barriers

(b) Agreement on Agriculture

(c) TRIPS

(d) TRIMS

(e) GATS

Q.20 Critically evaluate the assistance given by World Bank to the developing and developed countries.

Q.21 What are the functions and objectives WTO?

6.8 Answers to Check Your Progress

Answers: Self Assessment

1) B	(2) C
(3) C	(4) D
(5) C	(6) D
(7) C	(8) B
(9) Canada	(10) Bangkok
(11) Free Trade Agreement	(12) 1964
(13) 1945	(14) Reciprocity
(15) green box	(16) blue box
(17) Rules of Origin	(18) True

(19) True (20) False

(21) True

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STRUCTURE

7.0 LEARNING OBJECTIVES

After reading this chapter, students will be able to:

- Understand the meaning, role and components of financial environment
- Understand the meaning, role and components of financial system

- Understand the meaning, types, advantages and disadvantages of financial institutions
- Understand the objectives and structure of World Bank
- Understand the objectives, functions and structure of IMF

7.1 OPENING CASE: INDIA-CHINA ECONOMIC ENGAGEMENT

Chine is India‘s second biggest trade partner after the US. Chinese companies have significant market share in India, especially, electrical machinery & equipment, machinery & mechanical appliances, organic chemicals, plastics & articles, fertilizers, consumer goods segment, consumer electronics. China enjoys a big trade surplus with India. In Balance of Trade (BOT), if a country‘s exports are greater than it imports, it has a trade surplus or positive trade balance, and conversely, if a country‘s imports are greater than it exports; it has a trade deficit or negative trade balance. Balance of Trade of India is trade deficit with China. The Balance of Trade (BOT)/commercial balance/ net exports (sometimes symbolized as NX) is the difference between the monetary value of a nation's exports and imports over a certain time period.

In 2015, India imported goods worth $ 60.41 billion from China and exported $ 11.93 billion, hence, India‘s trade deficit was $ 48.48 billion. In 2019, India‘s import increased and reached worth $ 70.31 billion from China and export decreased $ 6.75 billion, India‘s trade deficit increased $ 53.56 billion from $ 48.48 billion.

There is a big presence of Chinese smartphone and electronic brands in India like Xiaomi, Vivo, Oppo, One-Plus, Realme. Chinese brands controls 81 per cent of the total smartphone market in January 2020 as compared to 67 per cent last year. Vivo is endorsed by Aamir Khan, Oppo by Ranbir Kapoor, Xiaomi‘s RedMi by Ranveer Singh and Salman Khan endorses Realme. Chinese companies sell their smartphones and electronic items trough retail chain/network & e-commerce platform/marketplaces like Amazon and Flipkart. Some companies like Xiaomi sold out laptops on the company-owned platform Mi.com . Midea is a leading Chinese brand in AC and appliances (US-China Joint Venture, Carrier Midea India in Indian Market).

Indian government started Made in India programme to facilitate investment, foster innovation, enhance skill development, protect intellectual property and build best in class manufacturing infrastructure in the country. As a result of this programme, some Chinese mobile companies have invested in India and manufacturing all components in India. As for example, Vivo is 100 per cent made in India with all the components and Midea products are locally manufactured. This type of programmes will certainly help India to tackle the problem of trade deficit or negative trade balance.

7.2 INTERNATIONAL FINANCIAL ENVIRONMENT

International financial management consists of several external forces, like foreign exchange market, international currency markets, institutions in international financial system, international financial markets and balance of payments. International financial environment is totally different from domestic financial environment as it deals with management of and trading in foreign currencies, foreign deposits and investment or foreign assets. For day to day operations, MNCs purchase and sell various foreign currencies, and involve exchange between various currencies generating Foreign Exchange (forex) market. Thus international financial management involves trade in borrowing and lending of foreign currencies or dealing with financial assets denominated in foreign currencies.

7.2.1 Foreign Exchange Market

The foreign exchange market refers to the network of banks, individuals and organised financial exchanges where the trade in global currencies takes place. The participants in the foreign exchange market are central banks, commercial banks, brokers, authorized dealers, corporate and individual customers. The key role of the central banks is to monitor market movements of the currency and sentiments of the market. RBI intervenes through policy as and when required. The function of buying and selling of foreign currencies in India is performed by authorized dealers/moneychangers appointed by the RBI. The foreign exchange departments of the major banks are linked across the world on a 24 hour basis. World forex markets are mostly centered on organised markets like New York, London, Tokyo, Amsterdam, Frankfurt, Milan, Paris, Toronto, Bahrain, Tokyo, Hong Kong and Singapore.

Every day, hundreds of billions of dollars worth of currencies are traded globally. Foreign exchange market is the market where the buyers and sellers are involved freely in buying and selling of currencies for payment settlements and delivery. The main functions of foreign exchange market are as following:

Transfer Function

The basic function of forex market is the transfer of funds in terms of foreign currency from one country to another country. It is the conversion of one currency into another through the credit instruments like, foreign bills of exchange, bank draft and telephonic transfers. The transfer function facilitates payments internationally.

Credit Function

Another function of foreign exchange market is to provide credit to importers to facilitate international business. The importer requires credit for foreign trade requirements like purchase of raw material, machinery, to take possession of goods, sell them etc. The credit is required for that period to enable the importer to pay by issuing bills of exchange, used in the international payments normally, have a maturity period of three months.

Hedging Function

Third and main function of the forex market is hedging function, to protect from exchange risks fluctuations. In a free foreign exchange market, the exchange rate changes, i.e., price of one currency with other currency fluctuates and it can cause gain or loss to the parties concern. To manage this situation, hedging facilities are provided through forward contracts in the forex market. Hedging helps to avoid the risk resulting from the fluctuations in values of currencies in future. Forward contract is a contract of buying or selling foreign currency at some fixed date in future at a price agreed upon now.

7.2.2 International Currency Markets

The major difference between domestic market and international markets is because of the different currencies. Currency refers to the physical aspects of a nation‘s money supply. There are round about 182 official currencies in the world. Hard currency refers to a globally traded currency. It is reliable, stable, and less volatile. This currency can be converted easily and its value cannot be depreciated. These are also called liquid currencies. There are ten currencies which are world's most liquid currencies. Traders used to buy and sell them in an open market.

Soft currency is a currency which is hyper sensitive and fluctuates frequently. Soft currency is unstable, unconvertible with other currencies because of which it is also called weak currency.

These currencies are least preferred for global trade. Generally, foreign exchange dealers avoid these currencies due to high fluctuations in exchange rates. Developing economies and underdeveloped economies with less stable governments, inconsistency in business policies, disturbance in political or the economic situation are having weak currency.

The most commonly traded currencies on the Forex market by volume are the U.S. Dollar (USD), the Japanese Yen (JPY), the Euro (EUR), the British Pound (GPB), the Canadian Dollar (CAD), the Australian Dollar (AUD), and the Swiss Franc (CHF). There are four major pairs of currencies pairs by volume in the forex market. The heavily traded pairs are the EUR/USD, USD/JPY, GBP/USD, USD/CHF. The EUR/USD currency pair is the world's most heavily traded currency pair covering 20 per cent of all the forex transaction, followed by USD/JPY.

7.3 INTERNATIONAL FINANCIAL SYSTEM

Economic development of a country depends upon well-developed financial system. The financial system of a country is a mechanism which mobilizes the savings of the country into productive sectors or activities for the economic development. It includes individuals, companies, markets and government that are exchanging financial assets.

Role/Functions of Financial System

The followings can be the major functions of a financial system:

- Provide a platform to savers and investors.
- Helps in capital Formation.
- Help in selection and finance of a project.
- It helps in moving financial resources beyond geographical boundaries.
- Provides detail information to all the players of market such as individuals, govt. and other institutions.

Components of Financial System

The followings can be the major components of a financial system:

- Financial Institutions/Intermediaries,
- Financial Markets,

- Financial Instruments/Products, and
- Financial services

7.4 INTERNATIONAL FINANCIAL INSTITUTIONS

An international financial institution (IFI) is a part of financial systems of world economies. It is a financial institution that has been founded by more than one country or by groups of countries to promote public and private investment to foster economic and social development in developing and developed countries.

Its owners or shareholders generally include national governments, banks and other organizations. The first International Financial Institutions, also known as Multilateral Development Banks (MDBs), were established after World War II to assist in the reconstruction of Europe and provide mechanisms for international cooperation in managing the global financial system. Later, regional development banks were founded to promote economic growth and cooperation. IFIs work internationally hence they have to follow international law.

Types of International Financial Institutions

- **Government-backed Institutions**

Federal Reserve, World Bank and International Monetary Fund are good examples of financial institutions which are inherently linked with a government. The IMF is an international institution that provides countries experiencing an economic crisis with a temporary loan to stabilize its economy. This loan is backed by the institution’s founder, the United States government. The World Bank is a specialized institution of the United Nations designed to give aid to governments, private agencies and corporations. The goal of these loans is to assist with development and health-related projects.

- **Private Institutions**

Several international institutions are private, such as Deutsche Bank, HSBC, Goldman Sachs and AIG. These companies make loans based on the risk level of the investment and the potential for profit. As is the case with most financial decisions: The higher the risk, the greater the potential reward. For example, a financial institution may decide to invest in Nigerian oil fields despite the government’s high level of corruption and known vandalism. The primary incentive under which private institutions issue loans is for the sake of increasing wealth to its shareholders.

Advantages and Disadvantages of International Financial Institutions

International financial institutions provide loan not only to governments during emergency but to the businesses also. By making funds available to them, IFI helps in the economic growth and development of a nation. Followings are the main advantages and disadvantages of International financial institutions:

Advantages

- **Economic growth and development-** Economic growth and development includes the development of all sectors of a country i.e. Govt. sector, private sector, household sector etc. As international financial institutions provide long term economical finance to their member countries, so it is easy for them to develop all the sectors of their economy.
- **Reduce poverty-** Easy availability of funds help to set up new industries which ultimate provide employment to the member countries. As the level of employment increases the poverty will reduce.
- **Consultancy Services-**Besides providing funds, many of these institutions endow with financial, administrative, technical advice and trade related guidance and consultancy to their member countries.
- **Provide long term finance on economical rates-**The commercial banks can fulfil short term finance requirement not long term. Financial institutions provide long-term finance on simple rate of interest and with convenient & economical facilities for repayment. This will helps to implements long term plans of modernization and development without much strain.
- **Help in Planning and Management-**Along with finance, a company can obtain specialist guidance and direction for the successful planning and management of projects in general and in reverse conditions also. The funds are made available even during periods of depression when other sources of finance are not available.

Disadvantages

- **Expensive and time-consuming procedure**-As these institutions come under government criteria, they follow rigid rules and regulation for granting loans. Too many formalities make the procedure time-consuming. Many deserving countries may fail to get assistance for want of security and other conditions laid down by these institutions.
- **Dispute settlement**-The dispute settlement system of these institutions provide for adjudication of issues pertaining to the internal policies of the member countries. Such provisions pose a threat to sovereignty of the countries.
- **Faulty lending procedure** is another problem for borrowings countries before granting any aid. These types of restrictions are not in favour of under-developed and developing countries.
- **Discriminatory**-These institutions are also criticized on the basis of discrimination adopted by it in its purpose - Lending procedure of these institutions laid more emphasis on the repaying capacity of the wise and region wise assistance towards developing countries.
- **Fails to maintain exchange rate stability**- it was in the objective list of these institutions but they failed to achieve it.

7.4.1 General Agreements on Tariffs and Trade (GATT) and Its Rounds

The General Agreement on Tariffs and Trade (GATT) was an International body which was signed on October 30, 1947 by 23 countries, including India, and come into force on January 1, 1948. It was founded as a general agreement of trade concession and to minimize trade barriers between countries by eliminating or reducing quotas, tariffs, and subsidies through legal regulations. The GATT was a post war development, made by the allied powers through reconstructing and liberalizing global trade and to create a well-developed mechanism of international trade and payments intended to boost economic recovery after World War II. The GATT held eight rounds in total from April 1947 to September 1986, each with significant achievements and outcomes. After serving for a period of 46 years, in 1995 the GATT was replaced by World Trade Organization (WTO).

General Agreement on Tariffs and Trade (GATT) Rounds

- **First round-** The first round was held in Geneva, Switzerland on October 30, 1947 and included 23 countries. The focus in this opening conference was on tariffs and it was the first attempt to write a rule book for commerce, and includes tariff cuts on one-fifth of world trade.
- **Second Round**-The second round was begun in April 1949 and was held in Annecy, France. Again, tariffs were the primary topic and accomplished an additional 5,000 tax concessions reducing tariffs. Ten new countries joined the GATT.
- **Third Round**-The third round was held at in Torquay, England in September 1950- April 1951. This time 38 countries were involved and almost 9,000 tariff concessions passed, reducing tax levels by as much as 25%.
- **Fourth Round**-The fourth round of GATT was held at Geneva, Switzerland in 1955-56. Japan became involved for the first time. It was decided by 26 countries that this time worldwide tariffs would be reduced by US$2.5 billion.
- **Fifth Round**-the fifth round also held at Geneva, Switzerland in 1960-62. This round is also known as Dillon Round, Named after U.S. Undersecretary of State Douglas Dillon, who proposed the negotiations. Involving 26 countries, the round focuses largely on harmonizing concessions within the new European Economic Community and about 4,400 tariff concessions covering $4.9 billion of trade.
- **Sixth Round**-The sixth round was held at Geneva, Switzerland in 1964-67. This round is also known as Kennedy Round, Named after assassinated U.S. President John F. Kennedy. This round covers 62 participating countries representing 75 percent of total world trade. Concessions cover trade valued at an estimated $40 billion.
- **Seventh Round**-the seventh round of GATT was held at Tokyo in 1973 and ended in 1979 in Geneva. The round involves 102 countries that negotiate agreements on tariff reductions and bindings - commitments not to increase current tariffs - which cover more than $300 billion of trade. Subsidies, government procurement and trade in dairy products and civil aircraft are brought under GATT's wing.
- **Eighth Round or Uruguay Round**- Eighth round of GATT was held at Punta Del Esta, Uruguay from September 1986 to December 15, 1993. Total 115 countries involved in it. It was most

ambitious round, bringing trade in services and agriculture into negotiations for the first time. The thorny issue of farm subsidies, which pits the United States against the EC, delays an accord by three years.

The Eighth round or Uruguay round of Multilateral Trade Negotiations were over on December 15, 1993. The final act was signed by 125 countries including India on April 15, 1994 under the chairmanship of Arthur Dunkel, then the Director-General of GATT. This was popularly known as Dunkel Draft or Dunkel Agreement. The GATT was finally replaced in World Trade Organization (WTO) in 1995.

Criticism of GATT

GATT was criticized on the following grounds:

- Before sixth round all member countries were following such agricultural trade policies which were inconsistent with GATT rules. Focus on agricultural trade was much less then industrial trade.
- Most of the tariffs had abolished by developed countries but still there were other tariffs which must be abolished others also.
- All the rules regarding subsidies were side tracked due to increased use of subsidies. That’s why GATT rules were not explicit on subsidies.
- GATT didn’t possess any mechanism to get its rules implemented by contracting parties.

7.4.2 World Trade Organization (WTO): Meaning, Preamble, Objectives, Structure, and Functions

GATT was replaced with the World Trade Organization (WTO). It has a set of rules and principles which were mutually designed to reduce tariffs & import barriers and promote international trade. It was come into effect on January 1, 1995 with the support of 85 member countries. Now WTO has 164 members (including European Union) and 23 observer governments (like Iran, Iraq, Bhutan, Libya etc) which represent 98% of the world trade. It is the third pillar of worldwide economic dimensions along with the IMF and World Bank. It has taken regulation and administration charges of global trade as decided in Uruguay round.

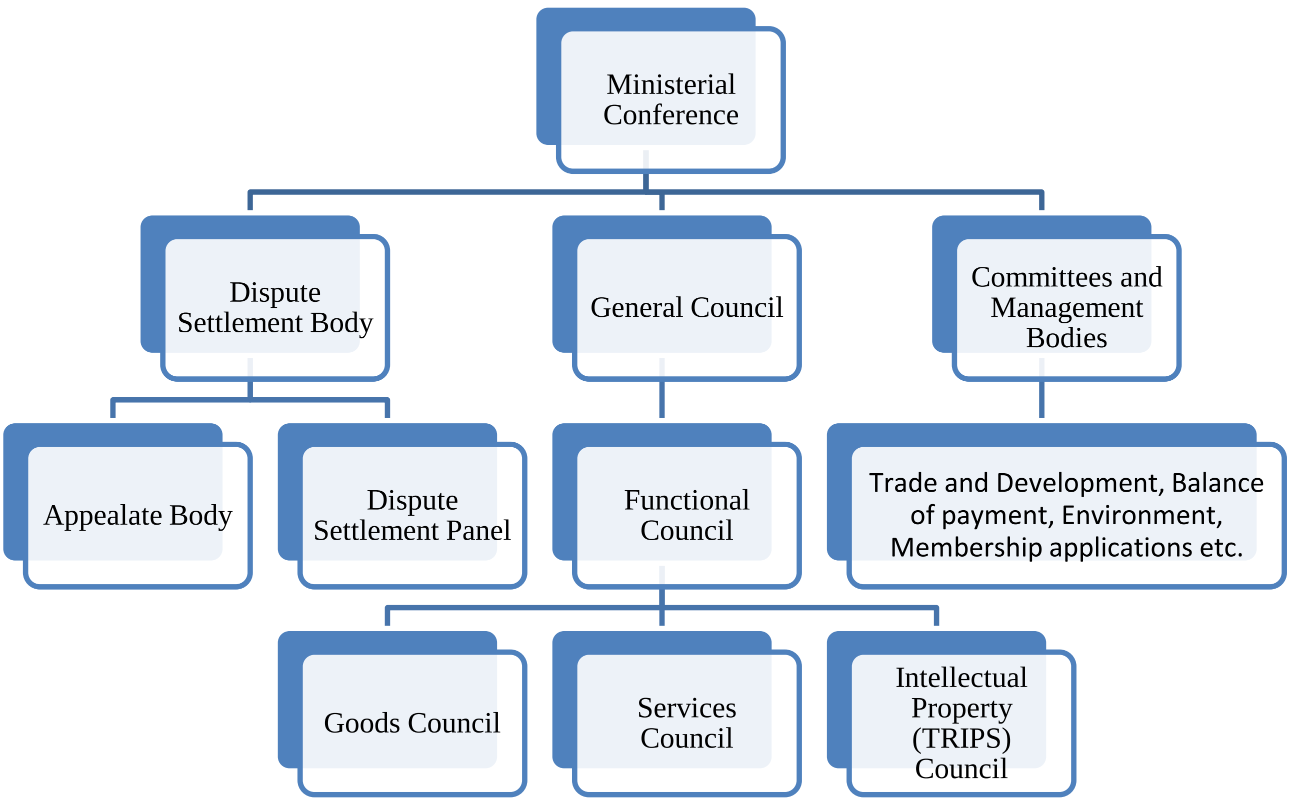
The World Trade Organization (WTO) is the only global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to ensure that trade flows as smoothly, predictably and freely as possible.

Preamble of WTO

The Preamble of WTO states that **"There is a need for positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development."**

Structure of WTO

The WTO has 164 members, accounting for 98% of world trade. A total of 22 countries are negotiating membership. Decisions are made by the entire membership. This is typically by consensus. A majority vote is also possible but it has never been used in the WTO, and was extremely rare under the WTO's predecessor, the GATT. The WTO's agreements have been ratified in all members' parliaments. WTO has four level hierarchical structure:



Organizational Structure of WTO

- **Ministerial Conference-** WTO's top level decision-making, policy & strategy making body is the Ministerial Conference in which includes all the representatives of member countries. This body meets once in every two years. All the decision regarding Multilateral Trade Agreements and WTO functioning come under the preview of this body.

- **General Council**- This is executive body of WTO. Ministerial conference formulates the policies and strategies implemented and executed through general council. General council meets several times a year in the Geneva headquarters. The General Council also meets as the Trade Policy Review Body and the Dispute Settlement Body.
- **Functional council under General council**-There is three Functional council:

➢ **Goods Council**- Multilateral Trade Agreements regarding goods came under this council.

➢ **Services Council**- Multilateral Trade Agreements regarding services came under this council.

➢ **Intellectual Property (TRIPS) Council**-Functioning relating to TRIPS undertakes by this council.

- **Committees and Management bodies-**Numerous specialized committees, working groups and working parties have been set up by Ministerial conference to discharge their respective function, such as Trade and development, Balance of payment, environment, membership applications and regional trade agreements.

Objectives of WTO

- The foremost objective of WTO is to lower trade barriers internationally through agreements and negotiations.
- To raise standard of living by providing large scale employment opportunities and to provide to provide goods and services on cheaper price.
- To cut the cost of doing business internationally.
- To encourage good governance and transparency at all levels.
- To provide a linkages between trade policies, environment policies and sustainable development.

Functions of WTO

- **Management of Multilateral Trade Agreements**-Proper management of Multilateral Trade Agreements on the reduction or elimination of obstacles to trade such as import tariffs and other barriers to trade and agreeing on rules governing the conduct of international trade (e.g. antidumping, subsidies, product standards, etc.).

- **Administration of WTO rules application**-Proper Administration, implementation and monitoring of the application of the WTO's agreed rules for trade in goods, trade in services, and trade-related intellectual property rights.
- **Administering TPRM**-Monitoring and reviewing the trade policies of members through Trade Policy Review Mechanism (TPRM), as well as ensuring transparency of regional and bilateral trade agreements.
- **Dispute settlement**-Settling disputes among member countries regarding the interpretation and application of the rules and regulation of agreements.
- **Coordination with World Bank and IMF**-Coordination with other International institutions like World Bank, IMF etc.
- **Conducting economic research**-Conducting economic research and collecting and disseminating trade data in support of the WTO's other main activities.
- **Awareness education**-Explaining to and educating the public about the vision and mission of WTO.

India and the WTO

India is a member of WTO since January 1995 and also had been a member of the WTO’s General Agreement on Tariffs and Trade (GATT) since July 1948. As a developing country, India has played a significant role in the proceedings of the WTO. It has also some of agreements with WTO. They are discussed below:

- **Reduction of Tariff and Non-Tariff Barriers-**The agreement proposes an overall reduction of tariffs on manufactured products and the phasing out of the quantitative restrictions over a period of time.
- **Trade-Related Investment Measures (TRIMS)-**This agreement forbids the host country to discriminate against investments from abroad vis-a-vis domestic investment i.e. agreement requires investment to be freely allowed by nations.
- **Trade-Related Intellectual Property Rights (TRIPS)-**Intellectual property rights seek to protect and provide legal recognition to the creator of the intangible and illegal use of his creation. It

includes patents, copyrights, geographical indications, trademarks, industrial circuits, designs and trade secrets. As a result, India amended the Copyright Act, the Patents Act, and the Trade and Merchandise Act.

- **Agreement on Agriculture (AOA)-**Uruguay round began with a goal to reduce or eliminate trade barriers in agriculture by doing something about the national agriculture policies that distort production, consumption and trade. This agreement deals with giving market access, reducing export subsidies and government subsidies on agricultural products.
- **Agreement on Sanitary and Phytosanitary measures (SPM)-**This agreement provides its member to take necessary measures for protection of its human, animal and plants. This further describes that measures should be based on scientific principles. This is particularly related to industries such as marine food, food processing and other packed food.
- **Multi-Fibre Agreement (MFA)-**This agreement is no longer applied. It was valid until 2004 only. It had essentially placed quotas on the amount of textile and clothing exports from developing to developed countries.
- **Agreement on Anti-dumping**- India have to follow the anti-dumping rules framed by WTO. According to the WTO, if a country wants to put an anti-dumping tariff on a trading partner, then that country needs to prove the occurrence of the dumping and its impact on the local market. Dumping is a price discrimination policy. It is practice of selling a product in one national market at a lower price that it is sold in another market. It can of three types:
    - **Sporadic dumping**-In this type of dumping companies dump excess unsold inventories foreign market at lower price to avoid price wars. If they are unable to sale then they dump by destroying excess supplies.
    - **Predatory dumping**-In the predatory the monopolist sale of goods in a foreign market at a price lower in the beginning to eliminate competition and increase the price when they leave the market.
    - **Persistent dumping**-When a country consistently sells products at a lower price in the foreign market compared to the local prices continuously.

- **Reverse dumping**-In reverse dumping a company charge a higher price in the foreign market and a lower price in the local market.

Latest Developments

There are four important recent developments related to India and WTO. These are as follows:

- **Ban on Chinese Mobile Apps** – As per the rules of the WTO, a country can take action against companies if it is a threat to the national security and sovereignty of the nation. As per above rule India banned 59 mobile apps of China. They have claimed that India has violated WTO rules but there is no bilateral agreement between India and China related to Smartphone apps.
- **Peace Clause-**Recently there was an issue high subsidies have seen in the global trade. The peace clause protects a developing country's food procurement programs against action from WTO members in case subsidy ceilings are breached.
- **Information and Communication Technology (ICT) Tariff Case**
- Japan and Taiwan filed a case against India in WTO over the import duties imposed on certain ICT goods. WTO has decided to set up a dispute panel against India. The dispute panels of the WTO would determine whether India's customs duties on imports of certain information and communications technology (ICT) products infringe WTO norms or not. India has stated that these ICT products are part of WTO's Information Technology Products (ITA-2) agreement. India is a part of ITA-1, signed in 1997.
- **Fisheries Subsidies**
- India has sought a clear dispute settlement mechanism in the global agreement to end harmful fisheries subsidies. WTO members are negotiating to finalize disciplines to eliminate subsidies for illegal, unreported and unregulated (IUU) fishing, and to prohibit certain forms of fisheries subsidies that contribute to overcapacity and overfishing.

7.4.3 World Bank: History, Objectives, Organization and Functions

History

The World Bank or the International Bank for Reconstruction and Development (IBRD) was established in 1945 during the Bretton Woods Conference, officially known as the United Nations

Monetary and Financial Conference, with a gathering of 44 nations, held at Bretton Woods, New Hampshire (USA) during July, 1944. They agreed upon a series of new rules for international financial and monetary order after the World War II. This conference gave birth to International Bank for Reconstruction and Development (IBRD) and International Monetary Fund (IMF). Primarily, IRBD was established to reconstruct and rebuild the destroyed economies in World War II.

Objectives

- Funding of large infrastructure projects such as dams, electrical grids, irrigation systems and roads.
- Help the developing countries in eradication of poverty, food production, rural and urban development, population, health and nutrition.
- Help the social development of developing countries through dealing with the issues of social life, education, climate change communication, cultural heritage etc.

All of these efforts support the Bank Group's twin goals of ending extreme poverty by 2030 and boosting shared prosperity of the poorest 40% of the population in all countries.

Organization of World Bank

World Bank is an International financial body, made up of 189 member countries. **Board of Governors** is the ultimate policymakers. Generally, the governors are member countries' ministers of finance or ministers of development. They meet once a year at the Annual Meetings of the Boards of Governors of the World Bank Group and the International Monetary Fund. The governors delegate specific duties to 25 **Executive Directors**, who work on-site at the Bank. The five largest shareholders appoint an executive director, while other member countries are represented by elected executive directors. The World Bank Group President chairs meetings of the Boards of Directors and is responsible for overall management of the Bank. The President is selected by the Board of Executive Directors for a five-year, renewable term. The Executive Directors make up the **Boards of Directors** of the World Bank. They normally meet at least twice a week to oversee the Bank's business, including approval of loans and guarantees, new policies, the administrative budget, country assistance strategies and borrowing and financial decisions. The World Bank operates day-to-day under the leadership and direction of the president, management and senior staff, and the vice presidents in charge of Global Practices, Cross-Cutting Solutions Areas, regions, and functions.

Functions of World Bank

The World Bank provides low-interest loans, interest-free credit, and grants not only for improving education, health, and infrastructure of its member countries but also to modernize a country's financial sector, agriculture, and natural resources management. The Bank's stated purpose is to "bridge the economic divide between poor and rich countries." It does this by turning "rich country resources into poor country growth." It has a long-term vision to "achieve sustainable poverty reduction."

- Help in reconstruction and rebuilding of countries emerging from war, the biggest cause of extreme poverty.
- Provide a customized solution to help middle-income countries by interest free financing.
- To promote private foreign private investment by means of guarantee of participation in loans and other investments.
- It provides policy advice through technical assistance and research analysis to developing countries.
- It also helps the member countries in capacity building.
- Helps the member countries in the areas of education, climate change, health, agriculture, infrastructure, administration etc.

WORLD BANK: A GROUP OF INSTITUTIONS

The World Bank Group consists of five development institutions:

- **International Bank for Reconstruction and Development (IBRD)**

International Bank of Reconstruction and Development was set up to revive the war destroyed economies. It has broadened its mandate to increase global economic growth and eliminating poverty. The Bank finances only in those projects which are backed by governments. Fast-growing economies like Indonesia, India, and Thailand, are often attracting a lot of foreign investment and large infrastructure building projects.

IBRD governed by Boards of Governors which consist of one Governor and one Alternate Governor appointed by each member country. The Board of Governors delegates most of its authority over daily matters such as lending and operations to the Board of Directors. Its Board of Directors consists of 25 executive directors and is chaired by the President of the World Bank Group. Executive Directors are appointed or elected by the Governors. Executive Directors select the World Bank President, who is the Chairman of the Board of Directors. Executive Directors are authorized for daily matters such as lending and operations.

- **International Development Association (IDA)**

IDA provides interest free loans to world's poorest countries. Overseen by 173 shareholder nations, IDA aims to reduce poverty by providing loans (called "credits") and grants for programs that boost economic growth, reduce inequalities, and improve people's living conditions. IDA supports a range of development activities that pave the way toward equality, economic growth, job creation, higher incomes, and better living conditions. IDA's work covers primary education, basic health services, clean water and sanitation, agriculture, business climate improvements, infrastructure, and institutional reforms.

It is governed by Boards of Governors consist of one Governor and one Alternate Governor appointed by each member country. The office is usually held by the country's minister of finance, governor of its central bank. The Board of Governors delegates most of its authority over daily matters such as lending and operations to the Board of Directors. Its Board of Directors consists of executive directors and is chaired by the President of the World Bank Group. Executive Directors are appointed or elected by the Governors. IDA lends money on concessional terms. This means that IDA credits have a zero or very low-interest charge and repayments are stretched over 30 to 38 years, including a 5- to 10-year grace period.

- **International Finance Corporation (IFC)**

IFC is the largest global development institution focused exclusively on the private sector. It helps in the economic development of the developing countries by investing in for-profit and commercial projects for poverty reduction and promoting development.

IFC is governed by Boards of Governors, it consist one Governor and one Alternate Governor appointed by each member country. The office is usually held by the country's minister of finance, governor of its central bank. The Board of Governors delegates most of its authority over daily to the Board of Directors. Its Board of Directors consists of executive directors and is chaired by the President of the World Bank Group. Executive Directors are appointed or elected by the Governors. Voting power on issues brought before them is weighted according to the share capital each director represents. The directors meet regularly to review and decide on investments and provide overall strategic guidance to IFC management. IFC attempts to guide businesses toward more sustainable practices particularly with regards to having good governance, supporting women in business, and proactively combating climate change.

- **Multilateral Investment Guarantee Agency (MIGA**)

MIGA was established in 1988 to promote foreign direct investment (FDI) into developing countries by providing guarantees (political risk insurance and credit enhancement) to investors and lenders. MIGA was created to complement public and private sources of investment insurance against non-commercial risks (currency inconvertibility and transfer restriction; government expropriation; war, terrorism, and civil disturbance; breaches of contract; and the non-honoring of financial obligations) in developing countries.

It is governed by Council of Governors which is representing by its member countries. The Council of Governors holds corporate authority, but primarily delegates such powers to MIGA's Board of Directors. The Board of Directors consists of directors and votes on matters brought before MIGA. Each director's vote is weighted in accordance with the total share capital of the member nations that the director represents.

- **International Centre for Settlement of Investment Disputes (ICSID)**

ICSID was established in 1966 by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention). The ICSID Convention is a multilateral treaty formulated by the Executive Directors of the World Bank to further the Bank’s objective of promoting international investment. States have agreed on ICSID as a forum for investor-State dispute settlement in most international investment treaties and in numerous investment laws and contracts. Bilateral investment treaties (BITs) are proliferating, many such treaties contain text that refers present and future investment disputes to the ICSID. ICSID provides for settlement of disputes by conciliation, arbitration or fact-finding.

It is governed by its Administrative Council which consist one representative of each Member State, and one vote per State. This council adopts ICSID arbitration, conciliation and fact-finding rules. Elects

Secretary-General and Deputy Secretaries-General. Each State designates persons to a list of arbitrators and conciliators. Its secretariat led by Secretary-General which provides technical and administrative support to proceedings. It is also offers training and technical assistance to governments and the public.

Membership of World Bank Group

For the membership of World Bank, a country must first join the International Monetary Fund (IMF). Membership in IDA, IFC, and MIGA are conditional on membership in IBRD. Membership in ICSID is available to IBRD members, and those which are a party to the Statute of the International Court of Justice (ICJ), on the invitation of the ICSID Administrative Council by a vote of two-thirds of its members.

India and the World Bank

India was one of the 44 founder members of International Bank for Reconstruction and Development (IBRD) and the International Monetary Fund (IMF). The bank had started lending to India in 1949 with a loan to the Indian railways. During the 1950s, the IBRD was India's sole source of World Bank borrowings. In 1960s, the United States, until then India's largest source of external resources, sharply cut its bilateral aid program. Since then, the WB emerged as the most important source of official long-term finance. In 1960s and 1970s, India was by far the largest recipient of IDA funds, accounting for more than two-fifths of all its lending. During the 1980s, while the WB shifted its emphasis to stress policy reforms and greater economic liberalization, it continued to lend to poorly governed public sector institutions in India and was muted in its criticism of India's closed economy. The lending portfolio changed sharply after the 1991 macroeconomic crisis. In the immediate aftermath, India became one of the last important WB borrowers to partake of structural adjustment lending, which supported policy reforms in finance, taxation, and the investment and trade regime.

Between 2015 and 2018, the World Bank lent around $10.2 billion to India. The World Bank Group (WBG) has approved a $25-30 billion commitment plan for India for the period 2019-22. Recently, World Bank’s Board of Executive Directors has approved a fast-track $1 billion financial aid for India for COVID-19 Emergency Response and Health Systems Preparedness Project. This fund will be utilized to prevent, detect, and respond to the COVID-19 pandemic and strengthen its public health preparedness. This is the largest ever health sector support from the Bank to India.

7.4.4 International Monetary Fund: History, Objective and Structure and Resources

History

In 1944, representatives of 44 nations met in Bretton Woods, New Hampshire, to draw up a plan for the post-World War II economic order. Their goal was to avoid a repetition of the destructive policies that could spark another conflict. So they created the IMF to promote international monetary cooperation. Ever since, the IMF has played a vital role in maintaining global economic stability and ensuring broadly shared prosperity.

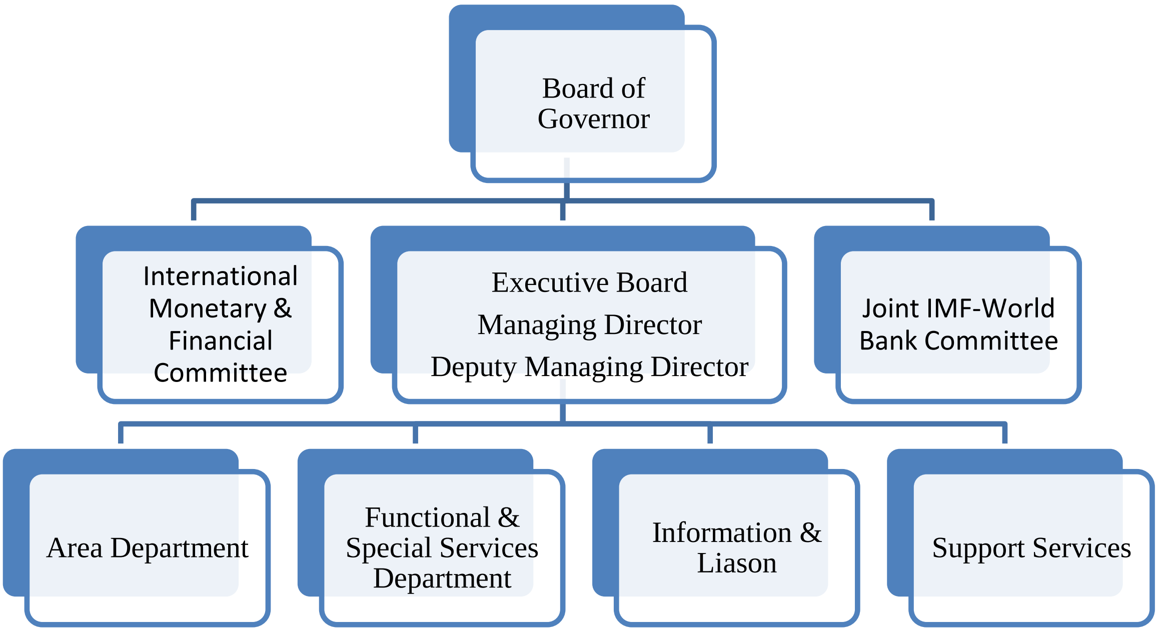
Objectives of IMF

- To promote international monetary co-operation through a permanent institutions, that will provide the mechanism for consultation and collaboration on international monetary problems.
- To promote exchange stability and to avoid the bad effects of depreciation on exchange rates.
- To facilitates the expansion of balanced growth by the promotion and maintenance of high level of employment as the primary objective of economic policy. It also helps to exploit natural resources and to put into productive channel.
- Establishment and multilateral trade and payment system in place of old bilateral trade by the elimination of exchange restrictions which hampers the growth of smooth trade relations in the world trade.
- To eliminate the disequilibrium in the balance of payment by selling or lending foreign currencies to the member countries. With its financial assistance and guidance, International Monetary Fund helps to lessen the degree of disequilibrium in the balance of payment of its member nations.
- To provide short-term monetary help to its member countries during any type of emergency.

Organization Structure of IMF

- **Board of Governors-**The Board of Governors is the highest decision-making body of the IMF. It consists of one governor and one alternate governor for each member country. The governor is appointed by the member country and is usually the minister of finance or the head of the central bank. While the Board of Governors has delegated most of its powers to the IMF's Executive Board.

The Boards of Governors of the IMF and the World Bank Group normally meet once a year. The Annual Meetings are chaired by a Governor of the World Bank and the IMF, with the chairmanship rotating among the membership each year. Every two years, at the time of the Annual Meetings, the Governors of the Bank and the Fund elect Executive Directors to their respective Executive Boards.



Organizational structure of IMF

- **International Monetary and Financial Committee (IMFC) -**The main purpose of this committee is to advice the IMF Board on common concern affecting the global economy and direction its work. The IMFC has 24 members, drawn from the pool of 189 governors. Its structure mirrors that of the Executive Board and its 24 constituencies. As such, the IMFC represents all the member countries of the Fund. The IMFC meets twice a year.
- **The Development Committee-**It is a joint committee of IMF-World Bank to discuss the issues related to economic development in emerging and developing countries. The committee has 24 members (usually ministers of finance or development).
- **The Executive Board-**The day to day operations of IMF is directed by its 24-member Executive Board which represents by all member countries. The managing director is the head of IMF staff and the chairman of Executive board is assisted by four Deputy Managing Director. Board meets

several times in the week to discuss all aspects of the Fund’s work, from the IMF staff's; annual health checks of member countries' economies to policy issues relevant to the global economy.

Resources of IMF

- **Quota**: Primary source of IMF’s financial resources is Quotas. Each member of the IMF is assigned a quota, based broadly on its relative position in the world economy which determines its maximum contribution in the IMF’s financial resources. The IMF regularly conducts general reviews of quotas to assess the adequacy of overall quotas and their distribution among members. The most recent increase in quotas, to SDR 477 billion (US$ 651 billion), was agreed under the 14th Review (concluded in December 2010, effective from January 2016.) The 15th Review was concluded in February 2020 without a quota increase.
- **Multilateral Borrowing**-Through the New Arrangements to Borrow (NAB) a number of member countries and institutions stand ready to lend additional resources to the IMF. The NAB constitutes a second line of defense to supplement IMF resources to forestall or cope with an impairment of the international monetary system. In January 2020, the IMF’s Executive Board approved a doubling of the NAB resources from the current SDR 182 billion to SDR 365 billion, for a new NAB period from 2021 to 2025. This doubling is subject to creditors’ consents and is targeted to become effective on January 1, 2021.
- **Bilateral Borrowing Agreements**-It serves as a third line of defense after quotas and the NAB. Since the onset of the global financing crisis, the IMF has entered into several rounds of bilateral borrowing agreements (BBAs) to ensure that it can meet the financing needs of its members. The current BBAs, agreed in 2016, were extended in 2019 for one further year and run through end-2020. To succeed these agreements, the Executive Board approved in March 2020 a framework for a new round of bilateral borrowing. The new framework is broadly the same as that agreed in 2016 for the current BBAs. The new BBAs are to take effect from January 1, 2021.

Special Drawing Rights (SDRs) – IMF issues SDR an international reserve asset, created by the IMF in 1969 to supplement its member countries’ official reserves. Member countries can voluntarily exchange SDRs for currencies among themselves. So far SDR 204.2 billion (equivalent to about

US$281 billion) have been allocated to members, including SDR 182.6 billion allocated in 2009 in the wake of the global financial crisis. The value of the SDR is based on a basket of five currencies—the U.S. dollar, the euro, the Chinese renminbi, the Japanese yen, and the British pound sterling. Holders of SDRs can obtain these currencies in two ways: first by voluntarily exchange and second by purchase i.e. member with strong external position purchases it from member with weak external position.

7.5 CHECK YOUR PROGRESS

1. The devaluation of currency of a country is done when____________

   (i) It has adverse balance of payments.

   (ii) It has favourable balance of payments.

   (A) Both (i) and (ii) are correct (B) Both (i) and (ii) are incorrect

   (C) Only (i) is correct (D) Only (ii) is correct

2. FDI is prohibited in:

   (A) Lottery Business including Government/private lottery, online lotteries etc.

   (B) Chit funds

   (C) Gambling and Betting including casinos etc.

   (D) All of the above

3. Which of the following items relate to BoP on capital account?

   (A) Foreign Investment (B) Loans

   (C) NRI remittances (D) All of these

4. If the value of visible exports exceeds the value of visible imports, the balance relates to:

   (A) Capital account BOP (B) Current account BOP (C) Balance of Trade

5. Component of current account in BOP:

   (A) Borrowing and lending (B) Investments

   (C) Export and import of goods (D) All of above

6. When a firm duplicates its home country based business activities in foreign market.

(A) Platform FDI

(B) Horizontal FDI

(C) Vertical FDI

(D) Portfolio Investment

Fill in the blanks:

7. **A ACCOUNT** shows capital expenditure and income for a country called_______________.

8. **A ACCOUNT** records export and import of visible and invisibles called_______________.

9. The investment is made to acquire an unrelated business in host country is called_______.

10. The______________of FDI refers to the total accumulation of foreign owned assets at a given time.

11. A country's Balance of Payment keeps track of both its__________to and its__________from other countries.

State whether the following statements are True or False:

12. The Department of Industrial Policy & Promotion is the nodal department for formulation of the policy of the Government on Foreign Direct Investment (FDI).

13. There is requirement of prior approval from Foreign Investment Promotion Board (FIPB) for automatic route FDI.

14. FDI contributes to the GDP and economic growth of the host country.

15. Overall BOP = Balance of current account + Balance of capital account + statistical discrepancy

16. Equilibrium in BOP is achieved when the net balance of all receipts and payments is either positive or negative.

7.6 SUMMARY

International financial management consists of several external forces, like foreign exchange market, international currency markets, institutions in international financial system, international financial markets and balance of payments. The foreign exchange market refers to the network of banks, individuals and organised financial exchanges where the trade in global currencies takes place. The participants in the foreign exchange market are central banks, commercial banks, brokers, authorized dealers, corporate and individual customers. The main functions of foreign exchange market are as following: Transfer Function, Credit Function and Hedging Function.

The most commonly traded currencies on the Forex market by volume are the U.S. Dollar (USD), the Japanese Yen (JPY), the Euro (EUR), the British Pound (GPB), the Canadian Dollar (CAD), the Australian Dollar (AUD), and the Swiss Franc (CHF). There are four major pairs of currencies pairs by volume in the forex market. The heavily traded pairs are the EUR/USD, USD/JPY, GBP/USD, USD/CHF.

The International Monetary Fund was established in 1945 to promote global trade, investment, and global economic growth by maintaining convertible currencies at stable exchange rates. IMF maintains international monetary cooperation among almost all of the world‘s countries. IMF promotes international monetary cooperation through a permanent institution that provides the system for consolation and collaboration on international monetary problems. It promotes exchange rate stability and to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation. It assists in the establishment of a multilateral system of payments and in the elimination of foreign exchange restrictions which restrict the growth of trade over global level.

The World Bank is an international organization established along with IMF and provides low-interest loans, interest-free credit, and grants to poorer and developing member countries.

The International Financial Market is the market place where financial wealth is traded among investors and countries. It comprises of stock market, bond market, currency market, derivatives market, commodity market and money market and the institutions which monitor and regulate the whole mechanism.

The Balance of Payment (BOP) of a country can be defined as a statistical statement that shows systematic record of all economic transactions of goods, services and income between a country and with the rest of the world during a specific period usually one year. The Balance of Trade (BOT) of a country refers to the difference in how much a country is importing versus exporting.

Favourable/surplus BOP is a condition when the payments received by a country are more than the payments the country has had to make. Payments deficit is a condition when the payments made by the country exceed payments received by the country.

Components of BOP are Current Account and Capital Account. Current accounts measure international trade, net income on investments, and direct payments. **CURRENT ACCOUNT** records export and import of visibles (also called merchandise) and invisibles (also called non- merchandise). Invisibles take into account services, transfers and income. In capital account **all international capital transfers are recorded.** Capital account is the record of inflow and outflow of capital including foreign investment, gold and foreign exchange reserves. **CAPITAL ACCOUNT** shows capital expenditure and income for a country. It gives a summary of the net flow of both private

and public investment into an economy. External commercial borrowing (ECB), foreign direct investment, foreign portfolio investment, etc., form a part of capital account.

A FOREIGN DIRECT INVES TMENT **(**FDI**)** is an investment made by a firm or individual in one country into business interests located in another country. FDI improves balance of payment position. FDI helps in obtaining foreign exchange resources. FDI helps in develops managerial capabilities. FDI increases employment and improve employees‘ efficiency. FDI improves the quality of products and services.

MNCs may exploit the labour and natural resources if there is no proper regulatory system in the country. The entry of large firms/multinational companies may displace/harm local businesses. If the domestic companies are not competitive and efficient, they may suffer losses, generate unemployment.

There are three types of FDI namely Horizontal FDI, Platform FDI and Vertical FDI.

7.7 KEYWORDS

International markets: Markets situated out of the boundaries of a country i.e. other than domestic market.

Reconstruction: It is the process of making a country normal again after a war.

TRIPs: It is an agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) is an international legal agreement between all the member nations of WTO.

Balanced Growth: Consistent growth of all sectors of an economy during a time period.

Economic development: Growth of a country in the way of GDP, per capita income etc**.**

Tariff: A tax or duty to be paid on a particular class of imports or exports.

Patents: A government authority or license conferring a right or title for a set period, especially the sole right to exclude others from making, using, or selling an invention.

MFN: A most-favored-nation (MFN) clause requires a country to provide any concessions, privileges, or immunities granted to one nation in a trade agreement to all other World Trade Organization member countries.

Quota: A fixed share of something that a person or group is entitled to receive or is bound to contribute.

Financial Services: It is concerned with the design and delivery of financial instruments and advisory services to individuals and businesses.

Loans: It refers to the financial assistance provided by the Govt. or banks or a financial institution to the borrower, which is repayable after some time with interest.

Grants: These are the financial aid awarded by the government for a specific purpose.

Subsidies: A subsidy is a benefit given by the government to groups or individuals, usually in the form of a cash payment or tax reduction.

7.8 SELF- ASSESSMENT TEST

Q.1 Describe the concept of FDI. Explain the advantages and disadvantages of FDI.

Q.2 Discuss the factors that makes the inflow of FDI in a country.

Q.3 How can FDI make positive contributions to the host and the home country?

Q.4 Do you think that FDI helps in growth of certain sectors of developing countries like India? Give reasons to explain your answer.

Q.5 Discuss the role of foreign investment in India.

Q.6 Explain the concept Balance of Payment. What are the components of BOP?

Q.7 What is Foreign Direct Investment? Elaborate the recent trend of foreign direct investment in

India.

Q.8 What is foreign portfolio investment? Explain with examples.

Q.9 What are the routes or modes to enter FDI in India?

Q.10.What are the main factors that constitutes international financial environment?

7.9 ANSWERS TO CHECK YOUR PROGRESS

(1) C	(2) D
(3) D	(4) C
(5) C	(6) B
(7) Capital	(8) current
(9) Conglomerate	(10) Stock
(11) Payment, Receipt	(12) True
(13) False	(14) True
(15) True	(16) False

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Foreign Exchange Market and Risk Management

STRUCTURE

8.0 LEARNING OBJECTIVES

Foreign exchange management is associated with currency transactions designed to meet and receive overseas payments. The objective of this chapter is to get the students acquainted with the basic concepts of Foreign Exchange, Foreign Exchange Market, Foreign Exchange Rates and Management of Exchange Rate.

After reading this chapter, students will be able to:

- Describe the concept foreign exchange, forex rate, forex risk management
- Explain different types of terminologies used in forex market
- Importance of determinants of forex rate
- Understand how companies manage foreign exchange risk

8.1 INTRODUCTION

Foreign exchange or Forex is the conversion of one country's currency into that of another. The price at which one currency is traded with another is called exchange rate. When international transactions occur, foreign exchange is the monetary mechanism which allows the transfer of funds from one country to another. The existing international financial environment always affects companies as well as individuals whenever they buy or sell products or services in global markets. Foreign exchange management is associated with currency transactions designed to meet and receive overseas payments. Beyond these transactions, foreign exchange management requires to understand the relevant factors that influence currency fluctuations or volatility. The currency fluctuations or volatility in global markets affects the decision-making ability as a buyer or seller of goods. The knowledge of these factors is important for the executives as they have to execute the proper strategy to manage risks and improve potential earnings.

8.2 FOREIGN EXCHANGE MARKET

The foreign exchange market refers to the network of banks, individuals and organised financial exchanges where the trade in global currencies takes place. The participants in the foreign exchange market are central banks, commercial banks, brokers, authorized dealers, corporate and individual customers. The key role of the central banks is to monitor market movements of the currency and sentiments of the market. RBI intervenes through policy as and when required. The function of buying and selling of foreign currencies in India is performed by authorized dealers/moneychangers appointed by the RBI. The foreign exchange departments of the major banks are linked across the world on a 24 hour basis. World forex markets are mostly centered on organised markets like New

York, London, Tokyo, Amsterdam, Frankfurt, Milan, Paris, Toronto, Bahrain, Tokyo, Hong Kong and Singapore. Every day, hundreds of billions of dollars' worth of currencies are traded globally.

8.2.1 Hard Currency vs. Soft Currency

The major difference between domestic market and international markets is because of the different currencies. Currency refers to the physical aspects of a nation‘s money supply. There are round about 182 official currencies in the world.

Hard currency refers to a globally traded currency. It is reliable, stable, and less volatile. This currency can be converted easily and its value cannot be depreciated. These are also called liquid currencies. There are ten currencies which are world's most liquid currencies. Traders used to buy and sell them in an open market. G10 currencies are considered as mostly traded in terms of volume which are as following: United States Dollar (USD), Euro (EUR), Pound Sterling (GBP), Japanese Yen (JPY)

New Zealand Dollar (NZD), Australian Dollar (AUD), Norwegian Krone (NOK), Canadian Dollar (CAD), Swiss Franc (CHF), and Swedish Krona (SEK).

Soft currency is a currency which is hyper sensitive and fluctuates frequently. Soft currency is unstable, unconvertible with other currencies because of which it is also called weak currency. These currencies are least preferred for global trade. Generally, foreign exchange dealers avoid these currencies due to high fluctuations in exchange rates. Developing economies and underdeveloped economies with less stable governments, inconsistency in business policies, disturbance in political or the economic situation are having weak currency. Zimbabwean dollar is a classic example of soft currency.

8.2.2 Major Forex Currencies with Symbols

- USD : US Dollar ($)
- EUR : EURO (€)
- JPY : Japanese Yen (¥)
- AUD : Australian Dollar ($ or A$ or AU$)
- GBP : British Pound (£)

- CHF : Swiss Franc (Fr)
- CAD : Canadian Dollar (CA$ or Can$ or C$)
- NZD: New Zealand Dollar ($ or NZ$)
- CHF: Swiss Franc (CHF)
- SEK: Swedish Krona (kr)

The most commonly traded currencies on the Forex market by volume are the U.S. Dollar (USD), the Japanese Yen (JPY), the Euro (EUR), the British Pound (GPB), the Canadian Dollar (CAD), the Australian Dollar (AUD), and the Swiss Franc (CHF). There are four major pairs of currencies pairs by volume in the forex market. The heavily traded pairs are the EUR/USD, USD/JPY, GBP/USD, USD/CHF and these pairs are part of the G10 currency group. The EUR/USD currency pair is the world's most heavily traded currency pair covering 20 per cent of all the forex transaction, followed by USD/JPY.

8.2.3 Important Functions of Foreign Exchange Market

Foreign exchange market is the market where the buyers and sellers are involved freely in buying and selling of currencies for payment settlements and delivery. The main functions of foreign exchange market are as following:

(i) Transfer Function

The basic function of forex market is the transfer of funds in terms of foreign currency from one country to another country. It is the conversion of one currency into another (also called transfer of purchasing power between countries) through the credit instruments like, foreign bills of exchange, bank draft and telephonic transfers. The transfer function facilitates payments internationally. As for example, if an Indian importer imports goods from USA, he requires US Dollar ($) for payments abroad. Then conversion from Rupees (₹) to US Dollar ($) is to be done in foreign exchange market and the payments are settled abroad through bills of exchange.

(ii) Credit Function

Another function of foreign exchange market is to provide credit to importers to facilitate international business. The importer requires credit for foreign trade requirements like purchase of raw material, machinery, to take possession of goods, sell them etc. The credit is required for that period to enable the importer to pay by issuing bills of exchange, used in the international payments normally, have a maturity period of three months.

(iii) Hedging Function

Third and main function of the forex market is hedging function, to protection from exchange risks fluctuations. In a free foreign exchange market, the exchange rate changes, i.e., price of one currency with other currency fluctuates and it can cause gain or loss to the parties concern. To manage this situation, hedging facilities are provided through Forward Contracts in the forex market. Hedging helps to avoid the risk resulting from the fluctuations in values of currencies in future. Forward contract is a contract of buying or selling foreign currency at some fixed date in future at a price agreed upon now. Thus, without transferring any currency, the forward contract makes it possible to ignore the likely fluctuations in the exchange rate of currencies and avoid the possible losses from such change.

8.2.4 Fixed Rate vs Floating Exchange Rate

Exchange rate is the rate at which one currency can be exchanged for another. There are two types of exchange rate systems in the foreign exchange market (i) Fixed Exchange Rate and (ii) Flexible Exchange Rate as explained following:

(i) Fixed Exchange Rate

A fixed, or pegged, rate is a rate officially fixed and maintained by the central bank/monetary authority (Reserve Bank of India) or government as the official exchange rate. The central bank can adjust the official exchange rate as and when required. The central bank sets and maintains the fixed rate by ensuring the proper demand and supply of the currency in the forex market. The central bank has to intervene time to time by buying and selling currency in the foreign exchange market to determine and set the rate. In order to maintain the rate, the central bank must keep a high level of foreign reserves so that it can maintain the fluctuations in the exchange rates of the currency by releasing or absorbing the liquidity of the currency in the forex market. The forex reserves are the amount of foreign currency held

by the central bank that can be used as and when required. The forex reserves increases or decreases depends upon the release or absorb extra funds into or out of the forex market.

(ii) Flexible Exchange Rate

In an open forex market, exchange rate depends upon the demand and supply of the currencies. A flexible exchange rate or floating rate is often termed "self-correcting," as any differences in supply and demand will automatically be reflected in terms of change in the rate of currency. If demand for a currency is low, its value will decrease, and if the demand for a currency is high, its value will increase. A floating exchange rate is constantly changing.

8.2.5 Terminologies used in Forex

Market Direct Quotes

Direct quotation is where the cost of one unit of foreign currency is given in units of local currency. Or simply when number of units of the domestic currency per unit of foreign currency is called direct quotes. As for example, 1$ = Rs. 74.60 is an American dollar direct quote of an Indian rupee in India.

Indirect Quotes

Indirect quotation is where the cost of one unit of local currency is given in units of foreign currency. In simple words, number of units of a foreign currency per fixed number of domestic currency; as for example, Rs. 1 = $ 0.0134 is an India Rupee indirect quote of a dollar.

Two Way Quotes

If any trader/customer wants to buy or sell the currency in foreign exchange market, he/she finds two types of quotes (a) Bid Price and (b) Offer Price

(a) Bid Price

Bid is the price at which a trader or dealer or customer is willing to buy another currency. As for example, a quote of Rs/$ is Rs 74.60, it means that the he wants to buy 1 $ at Rs 74.60.

(b) Offer Price

An offer price is the prices at which the trader or customer is willing to sell the currency. As for example, a quote of Rs/$ is Rs 74.65, it means that he wants to sell one dollar at 74.65. The difference between the bid rate and the offer rate is known as spread. Spread is the profit margins that a dealer expects to make.

Cash Rate

A rate quoted for transactions that will be settled on the same day (T+0) in the forex market is called Cash Rate.

Spot Rate

The rate quoted for transactions that will be settled two business days from the transaction date (T+2) in forex market is called Spot Rate.

Forward Rate

The rate quoted for transactions that will be settled beyond two business days at a mutually agreed rate and date is called Forward Rate. The contract for forward rate is called forward contract.

8.2.6 Important Determinants/Factors of Foreign Exchange Rate

Forex is the system of converting one national currency into another at a rate. Forex rate is an important indicator of a country‘s economic health. Exchange rates are the indicators most watched and analysed throughout the world and the governments used to take economic measures as well as decision on the basis of it. The changes in exchange rate impact the return of multinational companies and portfolio returns. So, it is very important to understand the factors or determinants of forex rate which are explained as follows:

Inflation Rates

The most important factor for variations in exchange rates is the difference in inflation rates between two countries. Lower inflation rate exhibits a rising currency value, as its purchasing power increases relative to other currencies. Higher inflation means depreciation of currency. This is also usually accompanied by higher interest rates. A higher rate of inflation will make a country‘s currency less attractive.

Changes in market inflation cause changes in currency exchange rates. High inflation rate means domestic goods are costlier than foreign goods and it will result in higher imports. This situation will create more demand for foreign currency, making it costlier. Automatically, the value of domestic currency will decline. Or we can say Indian currency will become weak in comparison of US $.

As for example, if a mobile phone costs $ 20 in US then it is quite natural that the exchange rate should be Rs 74/$1 in India and the mobile phone will costs Rs. 1480. But, if the value of Rs is declined due to changes in inflation rate, then the exchange rate might be, as for example, Rs 76/$1 (mobile phone will costs Rs. 1520).

Interest Rates

Changes in interest rate affect currency value and dollar exchange rate. The capital is attracted towards currencies yielding higher interest rates.

Interest rates, inflation, and exchange rates are correlated. Change in interest rates impact inflation and currency values. As the central bank (RBI) manipulates interest rates, both inflation and exchange rates are influenced. As for example, if Central Bank offers higher interest rates then the lender will get a higher return relative to other countries. Therefore, higher interest rates attract foreign capital and cause the exchange rate to rise. But, suppose, if the inflation rate is high in the country then the impact of higher interest rates will be lessen. The opposite relationship exists for decreasing interest rates – that is, lower interest rates tend to decrease exchange rates.

Country's Balance of Payments Position

If country‘s balance of payments position is favourable, it attracts more foreign investments. Foreign investment in the country leads to appreciation of the value of domestic currency.

National Income

An increase in national income will increase consumption and this phenomenon will attract foreign investment. This situation is favourable for forex rates.

Political Stability & Performance

If there is stable government, means having stable policies will generate healthier and competitive business environment. It will generate more demand of the goods and services and attract more foreign investments. This will lead appreciation or increase in the value of the currency.

Recession

At the time of recession, the value of domestic currency weakens in comparison of other countries, hence, resulting in lowering the exchange rates.

8.3 TYPES OF FOREIGN EXCHANGE RISK

There are three types of foreign exchange risk: (i) Transaction Risk (ii) Translation Risk (iii)

Economic Risk

Transaction Risk

Transaction risk arises due to appreciation or depreciation of the currency when a company is buying a product from overseas market. Suppose, a company is buying raw material from US market and the price of the raw material is denominated in $ (Selling company/country currency), and if the US currency appreciates, then the company doing the buying abroad will have to make more payments in its base currency to meet the contracted price.

Translation Risk

Multinational companies are having subsidiaries in overseas markets. Translation risk arises when there are financial transactions between parent company and subsidiary company abroad. The companies could face losses when the subsidiary's financial statements (which are in foreign currency) are to be translated in the parent company‘s currency.

Economic Risk

A multinational national company‘s market value is impacted by an unavoidable exposure to currency fluctuations. It is also called forecast risk.

The companies or investors which are subject to forex risk can implement hedging techniques, forward contracts and options to mitigate the risk. The techniques of foreign exchange risk management are as follows:

8.4 FOREIGN EXCHANGE RISK MANAGEMENT

The exchange rates of the currencies fluctuate frequently due to changes in interest rates, inflations, FDI & FII inflows as well as outflows, country‘s debt position, BOP positions, stable government policies, economic conditions etc. The frequent fluctuation in the forex rate could create financial loss if not managed properly. It is also called forex risk. Foreign exchange risk is a form of financial risk that arises from the change in the price of one currency against another.

Foreign Exchange rate volatility is unpredictable since there are many factors affect the movement of the currency exchange rates. So, foreign exchange risk management is important for oragnisations as well as investors dealing with foreign currencies or operating in overseas markets. Forex risk arises when there is a risk of an unfavourable change in exchange rate between two currencies before the date when the transaction is completed. Forex risk management is required in order to ensure better cash flows, manage unsystematic risks, avoid external financing, avoid financial distress, enhance shareholders wealth, and increases investor confidence. There are many tools of foreign exchange risk management: (i) Forward Contracts (ii) Currency Futures (iii) Currency Options (iv) Currency Swaps

(v) Leads and Lags (Leading and Lagging)

Forward Contracts

A forward contract is an agreement between the client and the bank to buy or sell currency at a specified price and date in future. Since, the rate of exchange is already fixed today for the future transactions, so, there is no effect of variability of exchange rate in the future.

Forward forex rate is the rate at which the transaction will be carried out in future at specific rate and date. Forward forex rates are developed to minimize the risk from fluctuations. The future date is agreed and fixed by the parties at today‘s rate of exchange.

Currency Futures

Currency futures are the standardised future contracts between two parties through the clearing houses to exchange one currency for another at a specified future date and at a predetermined price. Currency futures are organised trades facilitated by the exchanges. Appreciation or depreciation of the currency can be hedged by buying or selling currency future. The positions are reversed to close the deal at a specific date. If the investor had bought the futures, it will be sold at fixed future date at the current prevailing rate and vice-versa.

Currency Options

Currency options are contracts which provides the holder the right to buy or sell a specified amount of currency for a specified price over a given time period. Currency options are powerful tools for the companies and investors for carrying out cross border transactions. Holder has the right to buy or sell fixed amount of the currency at a fixed rate on a fixed date. The currency options are managed by organised exchanges. There are two types of currency options (i) Call Option: The right to buy a particular currency at a specified rate on a particular date (ii) Put Option: The right to sell a particular currency at a specified rate on a particular date.

Currency Swaps

A currency swap involves a legal agreement between two parties to exchange a series of cash flows in one currency for a series of cash flows in another currency, at agreed intervals over an agreed period. A currency swap is an agreement to exchange fixed or floating rate payments in one currency for fixed or floating payments in a second currency plus an exchange of the principal currency amount.

Leads and Lags (Leading and Lagging)

Leading and lagging refers to the technique of adjusting the timing of receipts and payments. This method works by adjusting the payments required reflecting future currency movements.

Leading

Leading technique works if the home currency is expected to strengthen in future. In the expectation of home currency depreciation, the company/investor efforts hard to collect the receivables from foreign debtors before they are due and the company pays the foreign currency to creditors before their due date.

Lagging

Lagging is a technique that works if it is expected that the home currency is going to weaken, the company delay the collection of receivables from foreign debtors and also to delay payment to creditors after their due date in the expectation of currency appreciation.

8.5 CHECK YOUR PROGRESS

True or False

1. Hedging helps to avoid the risk resulting from the fluctuations in values of currencies in future.

2. The rate quoted for transactions that will be settled 10 business days from the transaction date (T+10) in forex market is called Spot Rate.

3. A transactions that require delivery of currency at an agreed upon future date called forward market.

4. The spot rate of a currency is determined by government and market, in a free float system.

5. Bid is the price at which a trader or dealer or customer is willing to buy another currency

Fill in the blanks:

6. Hedging facilities are provided through________________contracts in the forex market.

7. Direct quotation is where the cost of one unit of foreign currency is given in units of

_______________.

8. You buy a currency in one market and sell it off in another, due to higher returns. This is known as

_______________.

9. The rate at which one currency is traded for another is called________________.

10. In a______________, the buyer of the option agrees to buy the underlying currency where in a ____, the buyer of the option agrees to sell the underlying currency.

Multiple Choice Questions

11. Which contracts of the following can be of any size?

(A) Futures Contracts

(B) Forward Contracts

(C) Both A and B

(D) None of these

12. Seek to earn risk-free profits by taking advantage of differences in interest rates among countries.

(A) Traders

(B) Arbitrageurs

(C) Hedgers

(D) None of above

13. Who buy and sell currencies when they expect movement in the exchange rate in a particular direction?

(A) Traders

(B) Arbitrageurs

(C) Speculators

(D) Hedgers

8.6 SUMMARY

Foreign exchange or Forex is the conversion of one country's currency into that of another. Foreign exchange management is associated with currency transactions designed to meet and receive overseas payments.

The foreign exchange market refers to the network of banks, individuals and organised financial exchanges where the trade in global currencies takes place. The participants in the foreign exchange market are central banks, commercial banks, brokers, authorized dealers, corporate and individual customers. World forex markets are mostly centered on organised markets like New York, London, Tokyo, Amsterdam, Frankfurt, Milan, Paris, Toronto, Bahrain, Tokyo, Hong Kong and Singapore. Every day, hundreds of billions of dollars worth of currencies are traded globally.

Hard currency refers to a globally traded currency. It is reliable, stable, and less volatile. This currency can be converted easily. Soft currency is unstable, unconvertible with other currencies because of which it is also called weak currency. These currencies are least preferred for global trade.

The most commonly traded currencies on the Forex market by volume are the U.S. Dollar (USD), the Japanese Yen (JPY), the Euro (EUR), the British Pound (GPB), the Canadian Dollar (CAD), the Australian Dollar (AUD), and the Swiss Franc (CHF). There are four major pairs of currencies pairs by volume in the forex market. The heavily traded pairs are the EUR/USD, USD/JPY, GBP/USD, USD/CHF.

The main functions of foreign exchange market are as following: Transfer Function, Credit Function, Hedging Function.

There are two types of exchange rate systems in the foreign exchange market (i) Fixed Exchange Rate and (ii) Flexible Exchange Rate. A fixed, or pegged, rate is a rate officially fixed and maintained by the central bank/monetary authority (Reserve Bank of India) or government as the official exchange rate. A flexible exchange rate or floating rate is often termed "self-correcting," as any differences in supply and demand will automatically be reflected in terms of change in the rate of currency. If demand for a currency is low, its value will decrease, and if the demand for a currency is high, its value will increase. A floating exchange rate is constantly changing.

Direct quotation is where the cost of one unit of foreign currency is given in units of local currency. Indirect quotation is where the cost of one unit of local currency is given in units of foreign currency. If any trader/customer wants to buy or sell the currency in foreign exchange market, he/she finds two types of quotes (a) Bid Price and (b) Offer Price. Bid is the price at which a trader or dealer or customer is willing to buy another currency. An offer price is the prices at which the trader or customer is willing to sell the currency. A rate quoted for transactions that will be settled on the same day (T+0) in the forex market is called Cash Rate. The rate quoted for transactions that will be settled two business days from the transaction date (T+2) in forex market is called Spot Rate. The rate quoted for transactions that will be settled beyond two business days at a mutually agreed rate and date is called Forward Rate. The contract for forward rate is called forward contract.

The factors or determinants of forex rate which are explained as follows: Inflation Rates, Interest Rates, Country's Balance of Payments Position, National Income, Political Stability & Performance, Recession

There are three types of foreign exchange risk: (i) Transaction Risk (ii) Translation Risk (iii) Economic Risk

Foreign exchange risk management is important for oragnisations as well as investors dealing with foreign currencies or operating in overseas markets. There are many tools of foreign exchange risk management: (i) Currency Futures (ii) Currency Options (iii) Currency Swaps (iv) Leads and Lags (Leading and Lagging) (v) Forward Contracts

A forward contract is an agreement between the client and the bank to buy or sell currency at a specified price and date in future. Forward forex rate is the rate at which the transaction will be carried out in future at specific rate and date. Currency futures are the standardised future contracts between two

parties through the clearing houses to exchange one currency for another at a specified future date and at a predetermined price. Currency futures are organised trades facilitated by the exchanges. Currency options are contracts which provides the holder the right to buy or sell a specified amount of currency for a specified price over a given time period. There are two types of currency options

(i) Call Option: The right to buy a particular currency at a specified rate on a particular date (ii) Put Option: The right to sell a particular currency at a specified rate on a particular date. A currency swap is an agreement to exchange fixed or floating rate payments in one currency for fixed or floating payments in a second currency plus an exchange of the principal currency amount. Leading and lagging refers to the technique of adjusting the timing of receipts and payments. This method works by adjusting the payments required reflecting future currency movements.

8.7 KEYWORDS

Direct Quotes

Direct quotation is where the cost of one unit of foreign currency is given in units of local currency.

Indirect Quotes

Indirect quotation is where the cost of one unit of local currency is given in units of foreign currency.

Currency Futures

Currency futures are the standardised future contracts between two parties through the clearing houses to exchange one currency for another at a specified future date and at a predetermined price

8.8 SELF- ASSESSMENT TEST

Q.1 Describe the basics of foreign exchange market and its operations.

Q.2 Explain the functions of foreign exchange market with example.

Q.3 Elaborate the types of exchange rate system in foreign exchange market.

Q.4 Distinguish between hard currency and soft currency.

Q.5 Explain the following terminologies:

(i) Cash rate

(ii) Spot rate

(iii) Forward rate

(iv) Bid price

8.9 ANSWERS TO CHECK YOUR PROGRESS

(1) True (2) False

(3) True	(4) False
(5) True	(6) Forward
(7) local currency	(8) Triangular Arbitrage
(9) exchange rate	(10) call option, Put option
(11) B	(12) B
(13) C	

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FOREIGN INVESTMENT	

STRUCTURE

9.0 LEARNING OBJECTIVES

After going through this lesson, the learner should be able to:

- Know the meaning and significance of Foreign Investment
- Understand the advantages and disadvantages of Foreign Investment
- Know the factors affecting International Investment
- Understand the Growth and Recent Trends in FDIs

9.1 INTRODUCTION TO FOREIGN INVESTMENT IN INDIA

Apart from being a critical driver of economic growth, foreign direct investment (FDI) is a major source of non-debt financial resource for the economic development of India. Foreign companies invest in India to take advantage of relatively lower wages, special investment privileges such as tax exemptions, etc. For a country where foreign investments are being made, it also means achieving technical know-how and generating employment. The Indian government's favorable policy regime and robust business environment have ensured that foreign capital keeps flowing into the country. The government has taken many initiatives in recent years such as relaxing FDI norms across sectors such as defense, PSU oil refineries, telecom, power exchanges, and stock exchanges, among others.

The economic liberalizations that swept across the world, particularly since the late 1980s, have very significantly changed the environment for international investments. At the same time, the surging international capital flows, in its turn, are substantially impacting the business environment. As Peter F. Drucker in his Managing for the Future observers, "increasingly world investment rather than world trade will be driving the international economy. Exchange rates, taxes, and legal rules will become more important than wage rates and tariffs."

9.1.1 Significance of Foreign Investment

Following the analysis of Donald MacDougall and Paul Streeten, Gerald Meier observes that, from the standpoint of national economic benefit, the essence of the case for encouraging an inflow of capital is that the increase in real income resulting from the act of investment is greater than the resultant increase in the income of the investor. If the value added to output by the foreign capital is greater than the amount appropriated by the investor, social returns exceed private returns. As long as foreign investment raises productivity, and this increase is not wholly appropriated by the investor, the greater product must be shared with others, and there must be some direct benefits to other income groups as mentioned below:

1. Domestic Labour: Domestic labour may get higher real wages because of the increase in productivity. There might also be an expansion of the employment opportunities.

2. Consumers: If foreign investment is cost-reducing in a particular industry, consumers of the product may gain through lower product prices. If the investment is product-improving or product-innovating, consumers benefit from better quality products or new products.

3. Government: The increase in production and foreign trade resulting from foreign capital might increase the fiscal revenue of the government.

4. External economies: Foreign capital may bring in a number of indirect gains through the realisation of external economies. For instance, if foreign investment is used for the development of infrastructure, this could stimulate domestic investment in industrial and other sectors.

There are various factors that signify the importance of FDI in India some of which are listed below:

1) Helps in balancing international payments:

FDI is the major source of foreign exchange inflow in the country. It offers a supreme benefit to country's external borrowings as the government needs to repay the international debt with the interest over a particular period of time. The inflow of foreign currency in the economy allows the government to generate adequate resources which help to stabilize the BOP (Balance of Payment).

2) FDI boosts development in various fields:

For the development of an economy, it is important to have new technology, proper management and new skills. FDI allows bridging of the technology gap between foreign and domestic firms to boost the scale of production which is beneficial for the betterment of Indian economy. Thus, FDI is also considered an asset to the economy.

3) FDI & Employment:

FDI allows foreign enterprises to establish their business in India. The establishment of these enterprises in the country generates employment opportunities for the people of India. Thus, the government facilitates foreign companies to set up their business entities in the country to empower Indian youth with new and improved skills.

4) FDI encourages export from host country:

Foreign companies carry a broad international marketing network and marketing information which helps in promoting domestic products across the globe. Hence, FDI promotes the export-oriented activities that improve export performance of the country.

Apart from these advantages, FDI helps in creating a competitive environment in the country which leads to higher efficiency and superior products and services.

9.1.2 Types of Foreign Investment

Broadly, there are two types of foreign investment, namely, foreign direct investment (FDI) and portfolio investment. FDI refers to investment in a foreign country where the investor retains control over the investment. It typically takes the form of starting a subsidiary, acquiring a stake in an existing firm or starting a joint venture in the foreign country. Direct investment and management of the firms concerned normally go together. If the investor has only a sort of property interest in investing the capital in buying equities, bonds, or other securities abroad, it is referred to as portfolio investment. That is, in the case of portfolio investments, the investor uses his capital in order to get a return on it, but has no much control over the use of the capital.

FDIs are governed by long-term considerations because these investments cannot be easily liquidated. Hence, factors like long-term political stability, government policy, industrial and economic prospects etc. influence the FDI decision, However, portfolio investments, which can be liquidated fairly easily, are influenced by short-term gains. Portfolio investments are generally much more sensitive than FDIs. Direct investors have direct responsibility with the promotion and management of the enterprise. Portfolio investors do not have such direct involvement with the promotion and management. Since the economic liberalisation of 1991, there has been a surge in the FDI and portfolio investments in India. There are mainly two routes of portfolio investments in India, viz., by Foreign Institutional Investors (FIIs) like mutual funds and through Global Depository Receipts (GDRs), American Depository Receipts (ADRs) and Foreign Currency Convertible Bonds (FCCBs). GDRs/ADRs and FCCBs are instruments issued by Indian companies in the foreign markets for mobilising foreign capital by facilitating portfolio investment by foreigners in Indian securities. Since 1992, Indian companies, satisfying certain conditions, are allowed to access foreign capital markets by Euro issues.

9.1.3 Disadvantages of FDI

Foreign capital, private and official (governmental and institutional) have certain limitations. Certain additional risks are associated with the private foreign capital. One of the important limitations to utilise the foreign capital is the absorptive capacity of the recipient country, i.e., the capacity of the country to utilise the foreign capital effectively. Lack of infrastructural facilities, technical know-how, personnel, inputs, market, feasible projects, inefficiency or inadequacy of administrative machinery etc. are important factors that affect the absorptive capacity. Sometimes ‘strings’ are attached to the official assistance—the recipient country may be pressurised to fall in line with the ideology or direction of the donor.

The following criticisms are levelled against foreign capital:

1. Private foreign capital tends to flow to the high profit areas rather than to the priority sectors.

2. The technologies brought in by the foreign investor may not be adapted to the consumption needs, size of the domestic market, resource availabilities, stage of development of the economy, etc.

3. Through their power and flexibility, the multinational corporations can evade or undermine economic autonomy and control, and their activities may be inimical to the national interests of particular countries.

4. Foreign investment, sometimes, have unfavourable effect on the Balance of Payments of a country because the drain of foreign exchange by way of royalty, dividend, etc., is more than the investment made by the foreign concern.

5. Foreign capital sometimes interferes in the national politics.

6. Foreign investors sometimes engage in unfair and unethical trade practices.

7. Sometimes, foreign investment can result in the dangerous situation of minimising/ eliminating competition and the creation of monopolies or oligopolistic structures.

8. FDI can also potentially displace domestic producers by pre-empting their investment opportunities.

9. Often, several costs are associated with encouraging foreign investment. Meier observes that these costs may arise from special concessions offered by the host country, adverse effects on domestic saving, deterioration in the terms of trade, and problems of balance of payments adjustment.

10. **Other Disadvantages**

- **Disappearance of cottage and small scale industries:** Some of the products produced in cottage and village industries and also under small scale industries had to disappear from the market due to the onslaught of the products coming from FDIs. Example: Multinational soft drinks.

- **Contribution to the pollution:** Foreign direct investments contribute to pollution problem in the country. The developed countries have shifted some of their pollution-borne industries to the developing countries. The major victim is automobile industries. Most of these are shifted to developing countries and thus they have escaped pollution.

- **Exchange crisis:** Foreign Direct Investments are one of the reason for exchange crisis at times. During the year 2000, the Southeast Asian countries experienced currency crisis because of the presence of FDls. With inflation contributed by them, exports have dwindled resulting in heavy fall in the value of domestic currency. As a result of this, the FDIs started withdrawing their capital leading to an exchange crisis. Thus, too much dependence on FDls will create exchange crisis.

- **Cultural erosion:** In all the countries where the FDls have made an inroad, there has been a cultural shock experienced by the local people, adopting a different culture alien to the country. The domestic culture either disappears or suffers a setback. This is felt in the family structure, social setup and erosion in the value system of the people. Importance given to human relations, hither to suffers a setback with the hi-fi style of living.

- **Political corruption:** In order to capture the foreign market, the FDIs have gone to the extent of even corrupting the high officials or the political bosses in various countries. Lockheed scandal of Japan is an example. In certain countries, the FDIs influence the political setup for achieving their personal gains. Most of the Latin American countries have experienced such a problem. Example: Drug trafficking, laundering of money, etc

- **Inflation in the economy:** The presence of FDIs has also contributed to the inflation in the country. They spend lot of money on advertisement and on consumer promotion. This is done at the cost of the consumers and the price is increased. They also form cartels to control the market and exploit the consumer. The biggest world cartel, OPEC is an example of FDI exploiting the consumers.

- **Trade deficit:** The introduction of TRIPs (Trade Related Intellectual Property Rights) and TRIMs (Trade Related Investment Measures) has restricted the production of certain products in other countries. For example, India cannot manufacture certain medicines without paying royalties to the country which has originally invented the medicine. The same thing applies to seeds which are used in agriculture. Thus, the developing countries are made to either import the products or produce them through FDIs at a higher cost. WTO (World Trade Organization) is in favour of FDIs.

- **World Bank and lMF aid:** Some of the developing countries have criticized the World Bank and IMF (International Monetary Fund) in extending assistance. There is a discrimination shown by these international agencies. Only those countries which accommodate FDIs will receive more assistance from these international institutions.

- **Convertibility of currency:** FDIs are insisting on total convertibility of currencies in under-developed countries as a prerequisite for investment. This may not be possible in many countries as there may not be sufficient foreign currency reserve to accommodate convertibility. In the absence of such a facility, it is dangerous to allow the FDIs as they may withdraw their investments the moment they find their investments unprofitable.

9.1.4 Government Initiatives to Promote FDI

The Indian government has initiated steps to promote FDI as they set an investor-friendly policy where most of the sectors are open for FDI under the automatic route (meaning no need to take prior approval for investment by the Government or the Reserve Bank of India). The FDI policy is reviewed on a continuous basis with the purpose that India remains an investor-friendly and attractive FDI destination. FDI covers various sectors such as Defence, Pharmaceuticals, Asset Reconstruction Companies, Broadcasting, Trading, Civil Aviation, Construction and Retail, etc.

In the Union Budget 2018, the cabinet approved 100% FDI under the automatic route for single-brand retail trading. Under this change, the non-resident entity is permitted to commence retail trading of ‘single brand’ product in India for a particular brand. Additionally, the Indian government has also permitted 100% FDI for construction sector under the automatic route. Foreign airlines are permitted to invest up to 49% under the approval route in Air India.

The main purpose of these relaxations in foreign investment by the government is to bring international best practices and employee the latest technologies which propel manufacturing sector and employment generation in India. To boost manufacturing sector with a focus on ‘Make in India’ initiative, the government has allowed manufacturers to sell their products through the medium of wholesale and retail, including e-commerce under the automatic route.

9.2 FACTORS AFFECTING INTERNATIONAL INVESTMENT

The theories of foreign investment described above have indicated several possible reasons for foreign investment. This section is a further extension of the important factors affecting international investment.

1. Rate of interest: One of the most important stimuli to international capital movements is the difference in the rate of interest prevailing at different places. Capital has a tendency to move from a country with a low rate of interest to a country where it is higher, other things being equal, interest rates or foreign exchange rates.

2. Speculation: Short-term capital movements may be influenced also by speculation pertaining to anticipated changes in the interest rates or foreign exchanges rates.

3. Profitability: Private foreign capital movement is influenced by the profit motive. Hence, other things being equal, private capital will be attracted to countries where the return on investment is comparatively higher.

4. Costs of production: Private capital movements are encouraged by lower costs of production in foreign countries. As Kreinin points out, we may distinguish between two types of cost-reducing investment. The first arises from the need to obtain raw materials from abroad. Such materials may be either unavailable at home or obtainable only at extremely high costs, but they are essential for the production and sale of final products at home or abroad. Without them, profit opportunities would remain unexploited. Indeed, vast investments in the extractive industries are motivated by the fact that the capital must go where the resources are. The second type of cost-reducing investment pertains to costs of commodities other than materials, primarily labour.

5. Economic conditions: Economic conditions, particularly the market potential and infrastructural facilities, influence private foreign investment. The size of the population and the income level of a country have an important bearing on the market opportunities.

6. Government policies: Government policies, particularly towards foreign investment, foreign collaboration, remittances, profits, taxation, foreign exchange control, tariffs, and monetary, fiscal and other incentives, are important factors that may influence foreign investment in a country. Foreign investment can have many undesirable consequences if not properly monitored and regulated.

7. Political factors: Political factors like political stability, nature of important political parties and relations with other countries also influence capital movements.

9.3 GROWTH OF FDI

Following the sweeping changes in the economic policy, foreign investment has been surging in many countries. Today, the worldwide FDI flows and stocks are about 20 times their size in the early 1980s. Trends in Magnitude of Flows although foreign direct investment flows have their ups and downs; the long-term trend has been one of fast growth. For example, between 1970 and 2000, FDI inflows worldwide increased more than a hundred times. The growth has been the sharpest between 1990 and 2000 thanks to the universal liberalisation, privatisation and the surge in cross-border M&As by these developments. It was estimated at $1461 billion in 2013. After peaking in 2000, the FDI flows had a downturn. The upward trend in inflows began again in 2004. FDI inflows peaked in 2007 ($2100 billion but was lower in subsequent years). While the FDI flows had their ups and downs, the stock of FDI has increased tremendously over time. Worldwide FDI inward stock increased from $1779 billion in 1990 to $5810 in 2000 and further to $11999 billion in 2006. FDI inward stock as a percentage of GDP increased more than four times between 1990 and 2013, from 8.4 per cent to 34.3.

Cyclical Behaviour FDI flows are characterised by cyclical behaviour. The decline in FDI flows after peaking in 2000 followed rapid increases during the late 1990s. As the World Investment Reports point out, there was a similar pattern during the late 1980s and early 1990s, and in 1982- 1983. Thus, this is the third downward cycle in FDI, each punctuating a long upward trend in FDI every ten years or so. Factors Affecting the Trend in FDI Flows The swings in FDI flows reflect changes in several factors. The main ones are business cycles, stock market sentiment and M&As. These short-term factors (including factors such as the terrorist attack of September 11, 2000) work in tandem with longer-term factors, sometimes offsetting and at other times reinforcing them. There is, on the other hand, a stable and positive relationship between global FDI flows and the level and growth of world GDP. Technological change, shrinking economic distance and new management methods favour international production. Their impact is, however, countered by cyclical fluctuations in income and growth. The decline in FDI in 2001 reflected a slowdown in the world economy. More than a dozen countries –

including the world’s three largest economies fell into recession. On the supply side, FDI is affected by the availability of investible funds from corporate profits or loans, which is in turn affected by domestic economic conditions. On the demand side, growing overseas markets lead TNCs to invest, while depressed markets inhibit them. The more interdependent host and home economies become, and the more widely a recession or upswing spreads, the greater are the corresponding movements in global FDI. Data for 1980-2001 show that a bulge in global FDI accompanies high economic growth, and a trough accompanies low growth. However, the relationship between GDP growth and FDI is not uniform across groups of economies. They go together in developed but not in developing countries. One explanation for the different patterns of FDI flows is that business cycles spread much faster across developed countries than others. A supplementary explanation may be that some countries (as in CEE) had been cut off from substantial FDI flows for so long that they have a lot of “catching up” to do – short-term cycles do not affect their attractiveness. The rise in global FDI flows in 2006 was partly driven by increasing corporate profits worldwide and resulting higher stock prices that raised the value of cross-border mergers and acquisitions (M&As). M&As continued to account for a high share of FDI flows, but greenfield investment also increased, especially in developing and transition economies. As a result of higher corporate profits, reinvested earnings have become an important component of inward FDI. They accounted for an estimated 30 per cent of total inflows worldwide in 2006 and for almost 50 per cent in developing countries alone. One of the important determinants of the FDI trend is the trend in cross-border M&A. For example, the dramatic increases in cross-border M&As led to record flows in 1999 and 2000. Cross-border M&As made its contribution to the decline in the FDI too.

9.4 RECENT TRENDS IN FDIS

Enthused by a record foreign investment inflow, India is optimistic of continuing to be one of the world's favourite FDI destinations in 2020 on the back of the Modi government's liberalised norms and a significant jump in the ease of doing business ranking. Secretary in the Department for Promotion of Industry and Internal Trade (DPIIT) Guruprasad Mohapatra said that despite a slowdown in the global economy, inflows of foreign investment into the country have not been impacted. India received a USD 27.2-billion foreign investment in the first half of 2019 and the pace is said to have sustained thereafter. The healthy growth in the overseas investments is proving that there is a lot of optimism and enthusiasm about India as a foreign investment destination. All the ministries, departments and states are working to address issues and providing stable policies to facilitate entry of foreign companies. Ease of doing business is very critical for FDI. Foreign companies look into the World Bank's ranking and they have been very impressed with India's much-improved ranking so far. The improvement in the business environment gives a pleasant experience to foreign investors as it helps in making processes easier. Some of the states are also wooing investments. So there is a need to further work on the areas in which the investments are coming and see how quickly and seamlessly, we can give those approvals. The global companies which are looking to shift their bases from China to India, the government is focusing on those firms which are looking at India as a second investment destination. In the World Bank's doing business report, India's rank has improved to 63rd this year among 190 economies from 77th last year. The department is also holding a series of meetings to further relax foreign direct investment norms in the coming months in areas like AVGC (animation, visual effects, gaming and comics), and insurance. Although, the FDI is allowed through automatic route in most of the sectors, certain areas such as defence, telecom, media, pharmaceuticals and insurance, government approval is required for foreign investors. Under the government route, the foreign investor has to take prior approval of the respective ministry/department. Through the automatic approval route, the investor just has to inform the RBI after the investment is made.

9.5 CHECK YOUR PROGRESS

Multiple Choice Questions:

1. _______________ is a major source of non-debt financial resource for the economic development.

a. Balance of Payment

b. Foreign direct investment

c. GDP

d. None of the above

2. Which of these factors affect the international investment?

a. Economic Conditions

b. Cost of Production

c. Both a and b

d. Only a

3. Which among them is not a disadvantage of FDIs?

a. Exchange crisis

b. Political corruption

c. Cultural erosion

d. Boost to cottage industries

4. Introduction of_________ & _________has restricted the production of certain products in other countries.

a. M&As

b. TRIPs & TRIMs

c. Exchange crisis & Economic Condition

d. FDIs &FIIs

5. Which among these institutions is in favour of FDIs?

a. IMF

b. World Bank

c. World Trade Organisation

d. IDBI

9.6 SUMMARY

Encouraged by the favourable business environment fostered by the global liberalisation, the international private capital flows have been increasing rapidly. Cross-border M&As have been the major driver of the recent surge in the FDI. Foreign capital now contributes a significant share of the domestic investment, employment generation, industrial production and exports in a number of economies, including China. Broadly, there are the following two types of foreign investment;

• Foreign direct investment (FDI) where the investor has control over participation in the management of the firm.

• Portfolio investment where the investor has only a sort of property interest in investing the capital in buying equities, bonds, or other securities abroad. In the case of portfolio investments, the investor uses his capital in order to get a return on it, but has no much control over the use of the capital. The major portfolio investment in the Indian capital market is by the foreign institutional investors (FIIs).

Broadly there are three economic motives of FDI, viz., resources seeking (e.g., exploiting the natural resources of the host country); market seeking (i.e., to exploit the market opportunities of the host countries) and efficiency seeking (like low cost of production deriving from cheap labour). The presence of any (or even all) of these determinants alone need not attract FDI. Several other factors like the political environment, government policies, bureaucratic culture, social climate, infrastructural facilities etc. are also important determinants of FDI. Although the international capital flows to the developing countries have increased substantially in the last one decade or so, they are still predominantly between the developed countries. A small number of countries account for the lion's share of the international capital inflows to the developing world. Although India has substantially liberalised its foreign investment policy, the FDI inflows had been much below the targets. India had not been getting even one-tenth the size of FDI flow to China. Even the cumulative FDI flow to India between 1991 and 2007 was less than the annual flow to China. Bureaucratic problems, certain unfavourable government attitudes, poor infrastructure, labour factors, high input costs etc. are regarded as the major reasons.

9.7 KEYWORDS

1. Foreign Direct Investment: A foreign direct investment (FDI) is an investment made by a firm or individual in one country into business interests located in another country.

2. M&As: Mergers and acquisitions (M&A) is a general term used to describe the consolidation of companies or assets through various types of financial transactions, including mergers, acquisitions, consolidations, tender offers, purchase of assets and management acquisitions.

3. Government Initiatives: The Government takes initiatives to increase FDIs in India as it has amended FDI policy to increase FDI inflow.

4. Recent Trends: Recent trends mean the recent inflows and outflows of investments which affect the Indian economy.

9.8 SELF-ASSESSMENT TEST

1. What are Foreign Direct Investments and its significance?

2. What are the negative impacts of foreign direct investment for India?
3. Which all factors affect the international investment?
4. What are the recent trends and growth in FDIs?
5. Discuss the government initiatives to enhance FDIs.

9.9 ANSWERS TO CHECK YOUR PROGRESS

1. Foreign Direct Investment
2. Both a & b
3. Boost to cottage industries
4. TRIPs & TRIMs
5. World Trade Organisation

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Organizational structure for International Business Operations

STRUCTURE

10.0 LEARNING OBJECTIVES

International organisational structure is the formal configuration between individuals and groups with regard to the allocation of tasks, roles, responsibilities, authorities designed by the top management. The objective of this chapter is to get the students acquainted with the basic need, importance and factors for designing organisation structure.

After reading this chapter, students will be able to:

- Describe the concept of international organisational structure
- Explain different types of international organisational structure
- Importance of a good organisational structure
- Understand how companies design international organisational structure

10.1 INTRODUCTION: ORGANIZATIONAL STRUCTURE FOR INTERNATIONAL BUSINESS

Large or small, every organisation having international business has to operate in a defined structure & specific culture. Organisation is defined as a formal structure, coordination and control systems with specific culture. It is the formal arrangement of departments, roles, responsibilities clarifying good relationships & support good communication within an organisation. It‘s a powerful tool to implement top-level strategies resulting in efficient and effective work process flow.

Every organisation has to implement various policies which give rise to many issues and challenges related with organisational structure. These organisational issues have to be addressed judicially to keep the business healthy and profitable.

The top management including board and senior leadership of the company are responsible to determine the type of organizational structure according to the policy framed. The organisational structure should best support the internal operations, smooth working, supporting work processes, the chain-of- command, good relationships, teams or work groups or units and good communication. Top management looks at all functions and determines how they would like work activities to be organized and carried out smoothly to achieve the objectives. This process also identifies natural reporting relationships and chain-of-command. Reporting relationships can be both vertical as well as horizontal. International organisational structure is consciously designed by the top management to achieve the success in strategy implementation. It provides the basic framework in which bosses/managers and subordinates/assistant-managers work together to achieve organisational objectives efficiently and effectively in scarce resources. It is related with reporting & controlling relationships, responsibilities & duties associated with the each role in the network of organisation.

In the context of strategic management, it signifies the design through which the strategy is formulated and implemented as per the desire of the top management.

Organisational structure is the formal configuration between individuals and groups with regard to the allocation of tasks, roles, responsibilities, authorities well within the formal configuration. It is a network of horizontal and vertical dimensions where employees functions to achieve preset goals.

10.1.1 International Organizational Structure – Need and Importance

It is hard and challenging for the top leaderships/management to manage an organization structure. The globalisation, economic crisis, and health disasters like COVID-19 (Coronavirus), force the top management to change strategies, switching their focus from marketing, production, competition to cost cutting, managing funds or survival strategies. Organisational redesign is required to support their people and businesses. When an organisational strategy is changed; the tasks, roles, responsibilities, authority and functions are to be realigned with the objectives. New structures could lower efficiency and confuse manpower and undermine effectiveness. Sound international organisation structure can contribute greatly to the survival continuity and stability of the enterprise. It dictates the relationship of roles and how employees work. It removes confusion within the roles, boosts coordination among functions, improves decision-making, and avoids unnecessary conflicts, stress and complexity.

Peter Drucker has rightly remarked, ―Good organisation structure does not by itself produce good performance, but a poor organisation structure makes good performance impossible, no matter how good the individual managers may be…. A good organisation structure… is not the only thing that matters in managing…. But the right organisation structure is necessary foundation; without it the best performance in all other areas of management will be ineffectual and frustrated.‖ The need and importance of organising and organisational structure can be understood more precisely on the basis of the following points:

(i) Facilitates Administration, Growth & Coordination

Sound international organisation structure helps in the performance of management functions like planning, staffing, directing and controlling. There is no scope of duplication of work, roles & responsibilities ambiguities, authority chaos, and miscommunication. Sound organisation facilitates the performance of various managerial functions by division of labour, proper delegation of work and clarity in authority and responsibility issues. Sound international organisation structure can help in keeping coordination and control of various activities under control between the headquarter and its subsidiaries in overseas market. An effective organisation facilitates delegation of authority and will certainly foster the spirit of constructive and creative thinking.

(ii) Optimum Use of Human Resources

Sound international organisation structure matches the jobs with the individuals and vice-versa. It ensures that right manpower is placed on the right job for which he is best suited. It improves better culture. There is requirement of good co-ordination among the various departments of subsidiaries abroad.

(iii) Stimulates Creative Thinking

Sound international organisational structure based on clear-cut demarcation of authority & responsibility, discretionary freedom granted to personnel, clarity in roles, coordination between teams, etc., will generate conducive environment to provide opportunity for the employees to work with full creativity, capacity, enthusiasm to give maximum to achieve organsiational objectives.

10.1.2 Factors to Consider in Designing the International Organizational Structure

International organisation structure provides a basis or framework within which managers and non-managerial employees perform the jobs assigned to them in the subsidiaries abroad. In other words, organisational structure may be considered as the core element around which various functions are performed and several processes operate. The structure of organisation is consciously designed by the top management to achieve objectives. However, in designing the international organisational structure, the following factors are to be considered: (i) Strategy & Objectives (ii) International Business Environment (iii) Technology (iv) People and (v) Size.

Strategy and Objectives

Multinational companies change strategy time to time to do changes in factors prevailing in international market. If management makes a significant change in its strategy, the structure will need to be changed. Design of structure begins with the formulation and implementation of the strategy. There is no way of devising what the main structure of an organisation should be, without an understanding of what the organisation is for and what objectives it is trying to achieve. Since an organisation is a strategy-oriented system, objectives determine its tasks and goals. In any case, there must be a _fit‘ between an organisation‘s strategy and structure for its success.

International Business Environment

An organisational structure requires to be designed according to the both internal and external factors in the environment. Internal factors consist of (i) Management Orientation (ii) Organisation Size and (iii) Employee Strength while external factors consists of (i) Uncertainty (ii) Differentiation and Integration

(iii) Globalisation vs Localization and (iv) Technology.

Internal Environmental Factors

(i) Management Orientation

Management orientation plays significant role in organisational structure. As for example the international companies which follows Ethnocentric management orientation, have strict control over subsidiaries. Parent company has strong control over subsidiaries. Polycentric management allows decentralization of authority and decision making. Geocentric management works according to the particular nationality.

(ii) Organisation Size

If the organisation is growing, then there is need of more departments and adequate structure because growing organisations require more staff positions to handle workload. The MNCs require rules, regulations, guidelines to better coordination and communication among employees of subsidiaries.

(iii) Employee Strength

When the companies' international business grows, more employees are required. More manpower is employed for both managerial and non-managerial jobs and various activities are assigned to them and

finally they are put in authority relationships. More employees means more formalized ways of doing work is required. It means the subsidiaries require formal policies, procedures, rules, system so that employees could formally work smoothly without conflict and complexity.

External Environmental Factors

(i) Uncertainty

The MNCs have to tackle many factors like shareholders, competitors, suppliers, customers, cultural influences, etc., of the external environment. If there are more uncertainties in the external environment in international market, then the companies are having highly decentralized decision making, fewer rules & regulations, and hierarchical & lateral communication channels. In stable international business environment, the companies are having centralized decision making and hard rules and regulations.

(ii) Differentiation and Integration

Differentiation means within the company, the departments are positioning themselves according to its own relevant external environment. Finance department considers the external environment from cash flows, interest rates, inflation rates, forex exchange rates, financial assets & instruments, etc., while production department considers external environment from cost cutting strategies, quality issues, automation, robotics, artificial intelligence, production point of view. In Integration, all the departments consider external environmental factors on collective and conclusive way.

(iii) Globalisation vs Localization

Companies having global strategy, considers standardised products strategy with low local responsiveness, while in localization strategy, the companies consider research and development as centralized and marketing as decentralized way. In international strategy, companies consider research & development, marketing, product & development strategy as centralized at home.

(iv) Technology

Technology has high impact on the organisational design of the MNCs. Technological aspect which refers to the manner in which various activities will be performed, is an important part of organisational structure. At individual level, the technology is the personal skills and knowledge of the employees. At department level, the procedures and techniques that group use to perform their assigned task. At

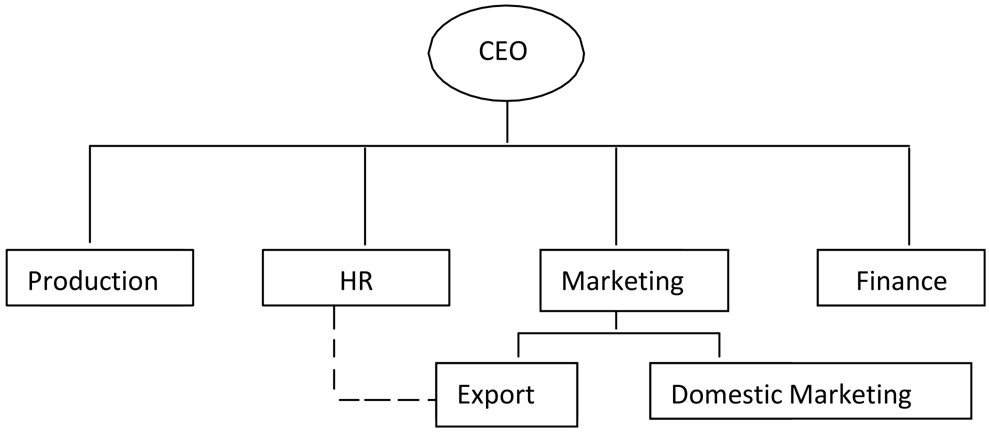
organisational level, technology means the efforts and machinery used to convert the inputs into outputs.

The span of management, shape of organisation, length of chain of command, number of managerial and non-managerial employees and flow of work, etc. might be greatly influenced by technological skills & knowledge of the employees.

10.2 INTERNATIONAL ORGANIZATIONAL STRUCTURE

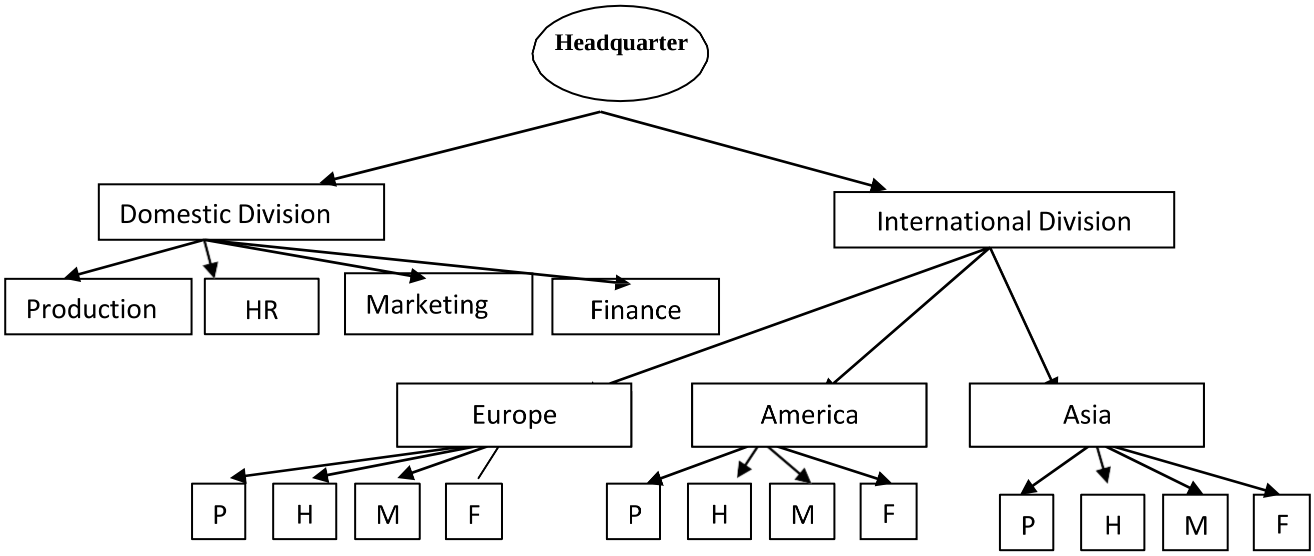
There are various types of international organisational structure like Export Organisational Structure, International Division Structure, International Functional Structure, International Geographical Structure and International Matrix Structure.

10.2.1 Export Organisational Structure



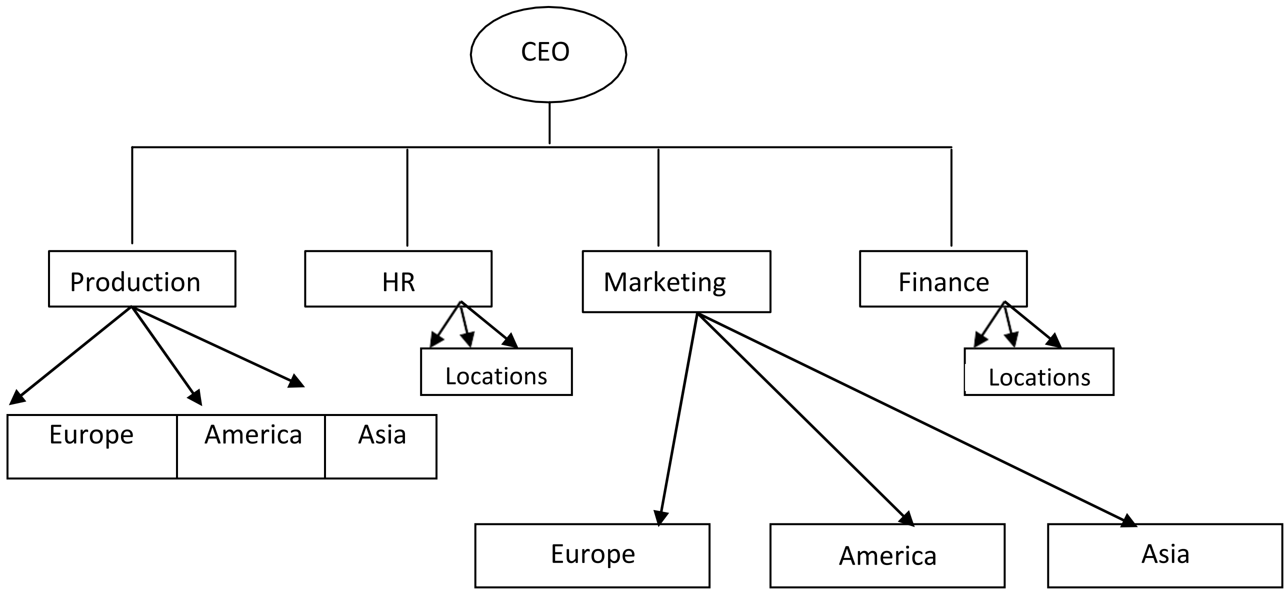
At initial stages, the company's marketing or sales department works and look after the exports in overseas market. CEO is supported by functional managers belonging to production, marketing, purchase, finance, personnel, R&D, etc. But, as the company's export volume and number of importer countries grow, the company's information flow increases at high level. In this scenario, the company establishes its separate Export Department to understand the customers' needs & wants, to handle grievances of the importers/customers abroad. The export activities are handled by the head of the Export Department designated as Director/Head/Manager. HR department keeps on recruitment and training & development activities for Export Department.

10.2.2 International Division Structure



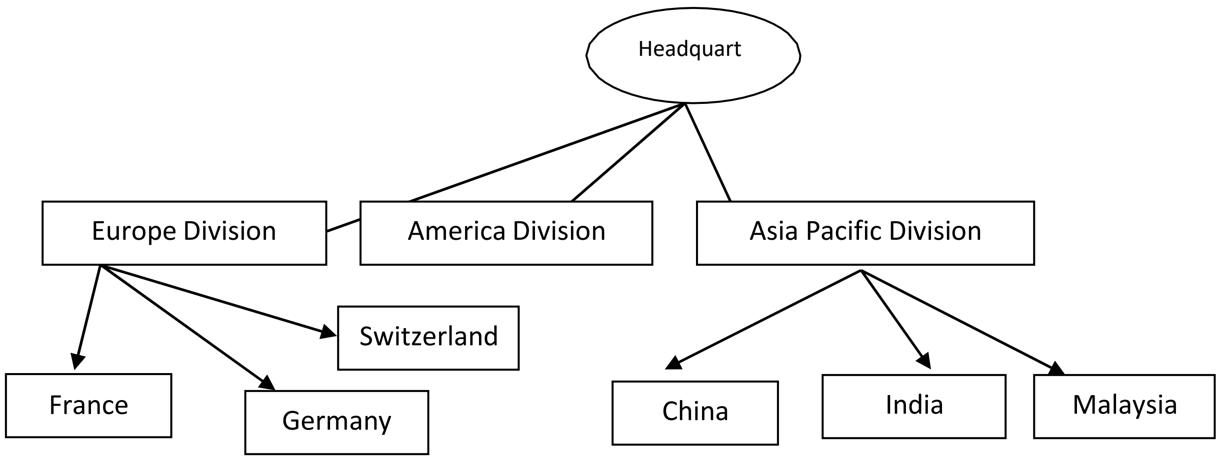
As the company grows and expands its business in overseas market, it establishes international division to cater the growth opportunities abroad. The domestic division is separate from international division usually run by Vice-President. International division have separate subsidiary in different countries, usually run by separate business heads. The in-charge/head of subsidiaries reports to the head of the international division. The international division is helpful in the decision making like resource management, programmes and activities, etc., in overseas market. The strategic control is exercised by the corporate office. The financial controls, exercised by the corporate office ensure that each division achieves the target profit, cash-flows and ROI. The main problem of the international divisional structure is that both the domestic managers and international managers may have divergent objectives. The second problem is related with the expansion of the business. As the overseas operations expand and diversify, this design of the structure fails to cope with the new demand.

10.2.3 International Functional Structure



In international functional structure, the functional areas are responsible for its activities around the world. As for example, production department is responsible for worldwide manufacturing activities in different overseas markets. Similarly, finance, HR, and marketing department are responsible for the activities in the subsidiaries abroad. The main advantage of this structure is that each functional area works with global market, so, the expertise as well as control will be beneficial for the MNC. The main problem of this structure is that sometimes the problems in the subsidiary in overseas market is diluted in the particular department and not properly understood by the oragnisation.

10.2.4 International Geographical Structure



In an international geographical structure, a firm‘s global operations are organised on the basis of regions or territories, each headed by a regional or territorial head responding to the CEO. It allows the independent heads of various geographical subsidiaries to focus on the local market requirements, monitor environmental changes, and respond quickly and effectively. Each region, which deals with all the products of the company, is made by and large independent with the required resource support and is expected to pursue region specific strategies. This structure is successful for those companies having market driven strategy but not suitable for the products which are technology based.

10.3 INTERNATIONAL MATRIX STRUCTURE

A matrix structure is a combination of the product divisions intersecting with various functional areas. Such structures are chosen when there is a need for more than one consideration for designing the organisational structure. Normally, a matrix structure reflects the integrated organisational structure such as, product focus as well as geographical thrust, or product focus as well as functional specialisation. Such structural design is helpful in interaction and flow of information throughout the organization. Since the matrix structure has an in-built concept of interaction between intersecting perspectives, it takes cross-functional aspects into consideration. Better quality of decision making, Face-To-Face contact, improved managerial motivation and development are some of the benefits of matrix structure. However, there are chances of confused/unclear job and task responsibilities in this

structure.

10.4 Check Your Progress

1. Which one is not a factor of international organisational structure?

   (A) Size

   (B) Profit

   (C) People

   (D) Objectives

2. Internal factors of international business environment do not include?

   (A) Management orientation

   (B) Employee strength

   (C) Differentiation and Integration

   (D) None of the above

3. External factors of international business environment do not include?

   (A) Organisational size

   (B) Globalisation vs Localisation

   (C) Uncertainty

   (D) None of the above

4. Functional structures help to create………………. .

   (A) Teamwork

   (B) Specialization

   (C) Project work groups

   (D) Multi-skilled employees

State whether the following statements are True or False:

5. Many internal conflicts are resolved at the lowest possible level in International Matrix Structure.

6. In an international geographical structure, a firm‘s global operations are organised on the basis of marketing function.

7. Firms with a low degree of diversification and a domestic structure based on function tend to use worldwide area structure.

8. Matrix structure allows local subsidiaries to develop products that fit into local markets.

9. Usually the domestic divisions and international divisions are significantly same in International

Division Structure.

10.5 SUMMARY

Organisation is defined as a formal structure, coordination and control systems with specific culture. It is the formal arrangement of departments, roles, responsibilities clarifying good relationships & support good communication within an organisation. International organisational structure is consciously designed by the top management to achieve the success in strategy implementation. It provides the basic framework in which bosses/managers and subordinates/assistant-managers work together to achieve organisational objectives efficiently and effectively in scarce resources.

Organisational redesign is required to support their people and businesses. Sound international organisation structure can contribute greatly to the survival continuity and stability of the enterprise. The need and importance of organising and organisational structure can be understood more precisely on the basis of the following points: (i) Facilitates Administration, Growth & Coordination, (ii) Optimum Use of Human Resources, (iii) Stimulates Creative Thinking.

However, in designing the international organisational structure, the following factors are to be considered: (i) Strategy & Objectives (ii) International Business Environment (iii) Technology (iv) People and (v) Size.

There are various types of international organisational structure like Export Organisational Structure, International Division Structure, International Functional Structure, International Geographical Structure and International Matrix Structure.

As the company‘s export volume grows, the company‘s information flow increases at high level. In this scenario, the company establishes its separate Export Department to understand the customers‘ needs & wants, to handle grievances of the importers/customers abroad.

International divisional structure has separate subsidiary in different countries, usually run by separate business heads. The in-charge/head of subsidiaries reports to the head of the international division. The main problem of the international divisional structure is that both the domestic managers and international managers may have divergent objectives. The second problem is related with the expansion of the business.

In international functional structure, the functional areas are responsible for its activities around the world. The main problem of this structure is that sometimes the problems in the subsidiary in overseas market is diluted in the particular department and not properly understood by the oragnisation.

In an international geographical structure, a firm‘s global operations are organised on the basis of regions or territories, each headed by a regional or territorial head responding to the CEO. This structure is successful for those companies having market driven strategy but not suitable for the products which are technology based.

A matrix structure is a combination of the product divisions intersecting with various functional areas. Better quality of decision making, Face-To-Face contact, improved managerial motivation and development are some of the benefits of matrix structure. However, there are chances of confused/unclear job and task responsibilities in this structure.

10.6 KEYWORDS

Matrix Structure

A matrix structure is a combination of the product divisions intersecting with various functional areas.

Chain of Command

Chain of command is a hierarchy of authority where those at the top of the organization direct and control the activities of the organizational members below them.

Span of Control

A span of control is a concept that describes the number of subordinates that are managed by someone.

10.7 SELF- ASSESSMENT TEST

Q.1 What do you mean by international organisational structure? Elaborate the factors impacting the international organisational structure.

Q.2 What are the internal and external factors of international business environment?

Q.3 Write a short note on the following:

i. Export organisational structure
ii. International functional structure
iii. International Division Structure
iv. International geographical Structure

Q.4 Explain various types of international organisational structure.

Q.5 Explain the important factors to be considered in designing the international organizational

structure.

Q.6 Write down the need and importance of international organizational structure.

Q.7 Explain the advantages and disadvantages of matrix structure.

10.8 ANSWERS TO CHECK YOUR PROGRESS

(1) B	(2) C
(3) A	(4) B
(5)True	(6) False
(7)True	(8) True
(9) False	

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International Business Negotiations, Developments and Issues

STRUCTURE

11.0 Learning Objectives
11.1 Introduction: Negotiation
11.2 International Business Negotiation
11.3 Major Developments in International Business
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11.0 LEARNING OBJECTIVES

An international business negotiation is the process of deliberate interaction of two or more parties where at least one of them a business entity originating from different countries. Major developments in international business are because of globalisation and the impact of globalisation on business is enormous. The objective of this chapter is to get the students acquainted with the basic concepts of international business negotiations, Developments and issues in International Business.

After reading this chapter, students will be able to:

- Describe the concept, and issues of international business negotiations

- Explain the forms and substances of a deal
- Understand process of international business negotiations
- Understand international business negotiations process
- Describe the concept of globalisation of business
- Explain various issues of international business
- Understand major developments in international business

11.1 INTRODUCTION: NEGOTIATION

A negotiation is a process of dialogue resolving an issue between two or more parties by strategically discussing in such a way that both parties find it acceptable. In negotiation process, each party tries to persuade the other party from its own point of view and agree on mutual interest, while optimising their individual utilities. By adopting negotiation process of resolving issue, the negotiating parties settle differences and try to reach some form of compromise that is acceptable for all involved parties.

Negotiations involve both some give and take, which means both party will always come at a situation where both benefits as well as some concession are also allowed. Parties involved in negotiations can be buyers and sellers, an employer and prospective employee, two companies of different geographical origins, or between the governments of two or more countries.

11.2 INTERNATIONAL BUSINESS NEGOTIATION

An international business negotiation is the process of deliberate interaction of two or more parties where at least one of them a business entity originating from different countries. Both parties are attempting to define or redefine their and perspective and interdependence in a business matter.

The parties to negotiation may include company-company, company-government, and interpersonal interactions over business issues i.e. sales, licensing, joint ventures, and acquisitions etc.

The term _negotiation‘ consists of two elements: common interests and issues of conflict. Without some common interest there is nothing on which parties will negotiate for, and without conflict there is nothing to negotiate about.

11.2.1 Definition of Negotiation

Negotiation is a process in which explicit proposals are tabled for discussion between parties to reach over an agreement on an exchange/on the realisation of a common interest where conflicting interests are present.

The negotiation process includes strategies and tactics that are used to reach over an agreement during interacting between groups with both common and conflicting interests.

International business negotiations take place within a broader framework than domestic negotiations. The art of politics and the concepts of social science become more important for the success of negotiation and hard-headed technical and financial calculation, legal and administrative basis are required for an overseas organisation.

Moreover, in international business negotiations, cultural differences are inevitable between negotiators from different countries. Cultural values and customs significantly influence the international business negotiations at each and every step of a negotiation. The diversity of cultures and values of negotiating partners often results in different approaches used in the negotiation process and variable expected outcomes.

Negotiating with executives from different cultures and ethnical background requires an understanding and adaptability to these differences. Special approaches and strategies for particular cultures are required.

Therefore, international business negotiations are more complex and difficult. Negotiators having different perspectives on negotiations lead to different styles of negotiation tactics. Other external factors such as domestic and international law, exchange rates, and economic growth also enhance the complexity of negotiations. International business negotiators need to understand each other‘s values so that they can adapt their negotiating approaches to emerging situations.

11.2.2 Process of Negotiation

Process of negotiation consists of three different negotiation stages including the pre- negotiation, actual negotiation, and post- stages. The effective flow of the negotiation process can determine the success of a negotiation.

Pre-negotiation stage:

It involves the preparation and planning for negotiation. It sets the tone and foundation for the process of negotiation. This is very important step because international business is very complex as well as risky and requires utmost care in each terms and conditions. This stage is of interactions between parties, such as building trust and establishing personal relationships, and the task-related behaviours which focus on the preferences related to various alternatives.

The buyer or supplier may be of different country. He or she may have perceptual differences because of cultural differences. Hence, it‘s important to take into considerations about the subject matter, guidelines, clarification of goals, rules of the organisation, must do‘s or must don‘ts, location, etc., prior the meeting for negotiation.

Generally, the first stage of negotiation emphasizes getting to know each other, identifying the issues, and preparing for the negotiation process.

Negotiation stage:

This stage focuses on what is termed as _win-win‘ stage. It involves a face-to-face interaction between parties, methods of persuasion during discussion, and the use of tactics. At this stage negotiators try to gain something positive through the process of negotiation and explore the differences in preferences and expectations related to developing an agreement. Both sides go through of a process of negotiation and feel that their point of view has been considered.

Post-negotiation stage:

Agreement can be achieved once there is complete understanding that both parties interest have been considered. Then in this last stage has some outcomes in the form of concessions, compromises, evaluating the agreement, and following-up the negotiation process.

All the three stages are often happen concurrently. The negotiation process is a dynamic process. It involves a variety of factors related to potential negotiation outcomes.

11.2.3 Culture and Negotiations

Culture consists of beliefs, thoughts, ethics, shared values, attitude, behaviour and patterns acquired and transmitted from generation to generation by the society. Cultural systems may be considered as products of action, or as a process of conditioning further action.

Culture influences how people think, communicate and behave. Culture provides the context for negotiation because it takes place within the framework of a culture‘s institutions and is influenced by its norms and values. Culture is a key factor that affects the negotiation processes and outcomes. Culture can influence the way people behave and interact at the beginning of the negotiation. Culture determines the way people perceive the things and approach the negotiating process and specific perspectives on power, time, risk, communication, and complexity. It is better for the international executives to understand the value system at work and develop problem solving behaviour that unfamiliar customs many pose. Individualistic behaviour of the negotiators are tending to involve in coercive or competitive behaviour and arguments whereas collectivist behavior of the negotiators emphasize on relationships and problem solving approach.

Cultural considerations significantly influence the form and substance of the deal. For example, when McDonald first franchised its operations in other countries it insisted on strict adherence to its traditional American menu. Differences in culture require adaptation of products, management systems, and personnel practices abroad, you need to be open-minded and consider your suppliers‘ suggestions for change.

11.2.4 Negotiation Outcomes and Performance

A negotiation outcome is the result of the negotiation process that is, the result of interaction between the partners. It includes partnership, contract, profit, winning, and the time expectations of the negotiation.

Different cultures have preference for a certain outcome. Therefore different culture owes different orientation. The great diversity of the world‘s culture makes negotiation very difficult. It does not matter how skilled or expertise the international managers have in negotiation, as the uncertainty to understand culture always remains. As in some cultures negotiation is considered as contract while in some cultures negotiation is considered as a relationships building process.

Some cultures see negotiation as a ‗Win-Win‘ strategy while some others consider it as ‗Win-Lose‘ strategy. ‗Win-Win‘ means both countries‘ executives have settled the problem solving process as a collaborative way. Japanese and Thai executives are having ‗Win-Win‘ approach.

International negotiators tend to be more skilful as a result of learning through experience. Inexperienced business negotiators who want to be internationally effective have to learn more about the cultural aspect of business negotiations.

For example, Chinese, Korean, and Japanese negotiators adopt a relationship and integrative approach while negotiating whereas American and mostly European negotiators emphasized contracts and less oriented towards a win-win approach. Americans consider a formally signed contract as a definitive set of requirements that strictly binds the negotiating parties and determines their interaction. On the other hand, Japanese and Chinese negotiators often consider relationship and interactive approach as the appropriate result of the process, not a signed contract.

11.2.5 Important Issues in International negotiations

Communication Barriers

Communication barriers largely affect the negotiation process and approaches. Different values, attitudes, interests, behaviour and languages which lead to communication barrier as these issues lead to misunderstanding, disagreement and a situation of chaos among two parties and even can break up business relationships.

Cultural Barriers

Cultural barriers also make it difficult to understand each other‘s behaviour. Different cultures have preference for a certain outcome. Therefore different culture owes different orientation. The great diversity of the world‘s culture makes negotiation very difficult. It does not matter how skilled or expertise the international managers have in negotiation, as the uncertainty to understand culture always remains.

11.2.6 Factors Affecting International Negotiations

An international business negotiation is affected by several factors that make them more complicated than those conducted among companies within the same country. Differences in laws and legal structures, cultural norms and religious traditions add to the complexity involved in reaching even the most routine business agreements.

The negotiation tactics that worked while dealing with Canadian conglomerate may not work while dealing with a Japanese counterpart. Therefore, an understanding of the factors that affect negotiations internationally is very important to be a successful negotiator.

Attitudes towards Risk

Every business negotiation contains some level of risk. Some cultures encourage risk-taking and adventurous behaviour, while others favour a more risk-aversive approach. Negotiators should understand the cultural attitudes about risk before proposing any agreements that may include high risk levels.

For instance, cultures such as individualistic cultures often encourage freedom of thought also encourage risk and exploration, while those cultures that favour traditional ideas may be less willing to depart from those ideas and explore risky situations.

Government-Business Relations

Relationships between governments and the businesses within their jurisdictions can also affect negotiations with overseas partners. Businesses in countries where the government encourages corporate growth and development operate differently than firms in countries with tight regulations.

For instance, the government of Thailand has encouraged entrepreneurs and welcomed international partnerships. In countries with stricter regulations, government bureaucracies can make international negotiations more difficult than American companies are accustomed to encountering.

For example when Microsoft made the announcement for purchasing Finnish mobile handset maker Nokia, it faced a lot of difficulties and complexity after the inking the contract such as the challenges of integrating employees belonging to different cultures.

Communication Style

Large barriers create in international negotiations when cultures clash over their communication styles. Even when both parties speak the same language, they may consider that the same words have different meanings.

A culture that emphasises on expediency, efficiency and fast results may consider the word "soon" as meaning "immediately." The same word, "soon," might provide meaning mean days, weeks or even months to cultures that emphasis on taking their time and evaluating every aspect of the agreement.

Corporate Structure

Cultural aspects also affect how companies structure their decision-making processes. Some cultures favour an authoritarian, top-down approach while others seek out consensus and group unity.

For instance, American companies tend to have a lead negotiator who speaks for the entire group. Many Asian cultures, including the Japanese and Chinese, favour consensus and teamwork when reaching a decision. These differences can lead to unmet expectations and frustration from both parties, so identifying the structure of the negotiating team is a vital part of a successful international negotiation.

11.2.7 Business Negotiation Preparation

All good negotiation is based on well-chosen strategies and tactics adapted to meet new challenges. Preparations for negotiation are based on intelligence and negotiation research. It is usually said that if we don‘t prepare wisely beforehand, then we‘re likely to be in for a bumpy ride.

1. Consider the objective of negotiation

The international executives must always understand the goals or objectives clearly of negotiation. Next, they must know the authority limits prior to the negotiations, i.e., do‘s and don‘ts related with the deal. It is very important that if any business negotiation agreement is reached, it is not to be considered binding until the appropriate decision-makers have given the agreement their stamp of approval.

It may also be helpful if the negotiator has sufficient authority to suggest to their counterpart, that the preliminary agreement has a good prospect of being accepted by the principal decision-makers. This should all be determined internally prior to the start of any international business negotiation.

2. Build a team

Most international business agreements are prepared for and executed by negotiation teams. The team will be helpful for preparation to negotiate. This team must include experts of different fields. The team must have single spokesperson, and technical experts, if required. All the members must have clear-cut agenda and their respective roles. Negotiation preparations amongst these various individuals should occur prior to departure.

Team members should understand the responsibilities and tasks assigned to them so that there could be smooth flow of negotiation process. Sometimes, in overseas markets, the international executives are required interpreter or translator. Arrangement of qualified and competent interpreter or translator will solve the issues in difficult time if briefed on the nature of the negotiations. They can be asked to provide assistance in understanding the cultural nuances besides language difference that might be encountered.

3. Research the other side

The negotiator is required to estimate what alternatives may be available on the side of counterpart. Then he must value associated with each alternative available to the counterpart. Then, what alternative might be the most important for the counterpart. This information will be helpful at the time of negotiation. Further, business background and personalities of the other side might reflect the deal. The negotiator is required to know and understand the country‘s political climate, economy, culture and customs and legal system. The local or regional business climate, where the primary business is to be conducted is important, as is their international standing with their neighbouring countries.

4. Consider all the options

It is always better to identify all the alternatives the negotiator might pursue. Further, the negotiator must value associated with each alternative. The negotiator must consider the BATNA, i.e., Best Alternative to a Negotiated Agreement. Negotiation Skills Training strives to consider many alternatives. Of the most probable and high-risk options, the negotiator has to compare the best alternative to a proposed agreement, to see how it measures up.

5. Know goals of negotiator and counterparty

One of the best ways to determine the other side's interests is to interact with the negotiation agent or parties who will already be involved with the preliminary arrangements. Be cautious though, especially if the agent who represents the other side is acting as an independent, as they may have their own self- serving negotiation agenda.

6. Identify the Issues

It is crucial to fully understand all the issues that might arise from both parties, throughout the business negotiations, so that prior to meeting, the negotiator can prepare to address them.

7. Consider multiple proposals

The negotiator must have all the options of the deal in his mind. The negotiator must start the process of negotiation tactfully. If, he is not getting all the terms and conditions in the proposal then he should proceeds towards some relaxations in the terms and conditions. So, he must be ready with all the multiple proposals in his mind.

He must not be adamant with stagnant approach with his first proposal. By keeping the big picture, he should move cautiously and judiciously. There will be many occasions where the first draft business proposal may appear as a sign of rejection. Each situation must be analysed to gauge the opening moves. Also, if we insist on the terms of our first draft, our uncompromising attitude may result in a prolonged negotiation, or a failure to find agreement.

Good business negotiation preparation is very important to any successful negotiation. When dealing with a business culture that marches to the beat of its own drum it becomes extremely important. The more the negotiator adequately prepare beforehand, the more likely is he able to anticipate problems further down the road, that might hamper a successful negotiation.

11.3 MAJOR DEVELOPMENTS IN INTERNATIONAL BUSINESS

International companies look at global markets to remain profitable. Before examining foreign markets, the international managers are required to be aware of the major developments in international business so that they can take advantages of latest trends and might get favor for their companies. International markets are evolving rapidly, and international managers can take advantage of the changing environment for their companies. Major developments in international business are because of globalisation. The impact of globalisation on business can be placed into four broad categories namely globalisation of markets, globalisation of production, globalisation of investments and globalisation of technology.

11.4 THE IMPORTANT ISSUES IN INTERNATIONAL BUSINESS

Most of the top management of international businesses have concerns regarding Social issues, Ethical Issues, Labour Issues, Environmental Issues, Legal & Regulation Issues, Cyber Security Issues, Geopolitical Uncertainty. The international managers must understand the issues in international business which may affect their role. The main concerns of global managers are as following:

(i) Legal Issues of International Business

International businesses are subject to legal issues because each nation has its different set of regulations of business. These legal issues are primarily related with jurisdiction, intellectual property rights, taxes and security, cyber-specific issues, consumer protection, custom duties, security & exchange, forex issues, etc. The MNCs have to prepare and be proactive for having legal strategic planning accordingly.

Jurisdiction

Jurisdiction is the primary issue for any company doing international business. The legal system forces the businesses to abide by rules of the country. Legal system vary from country to country and country‘s judicial system matters a lot for MNCs. Free and fair judicial system boost the confidence of the MNCs.

Intellectual Property

Copyright and trademark protection in different countries should support the MNCs. Intellectual property rights may be well protected in one nation than other nations. The international companies must be vigilant and proactive in the area of protection of intellectual property rights.

Taxes and Security

Investments in the form of FDI and FII need prior approval from the apex/central body or governments of host countries and the provisions of taxes and security are different in different countries for the same.

Cyber-specific issues

MNCs seem to recognize the threat to innovation and profit if underlying issues surrounding network security, cyber attacks, cyber threats, etc., are not adequately addressed. While, cyber crime, cyber attacks & cyber threats poses significant challenges to the international companies globally, the international companies should be vigilant on the internet and cyber-specific areas. The websites and the domain names must be registered and protected as the companies go for online business practices. The new mobile and internet technologies, cloud computing, high-speed broadband, etc., have made the system sensitive and vulnerable to the cyber attacks and unauthorised access. To make MNCs servers sound and bulletproof from cyber attacks is a mega challenge now-a-days. Cyber crime & attacks imposes a number of direct costs on global companies like theft of financial assets, server hacking, domain name issues, loss of intellectual property, violation of confidential information, costs of recovering/restoring violated data, damage to company‘s reputation, etc.

(ii) Ethical & Social Responsibility Issues of International Business

The term business ethics refers to the system of moral principles and rules of conduct applied to business by MNCs. The varying ethical norms and values make the international business environment very complicated and confusing. Moral obligations of multinational companies are a highly debatable issue worldwide. If the harmful effects of a product outweigh the benefits, a company with sound ethics will not do business in that product even if there is no legal objection.

In the environment of globalisation & modern economic development, the international business can no longer functions in isolation. MNCs social responsibility of business is judged in the manner it carries out its own business activities and the welfare activities it performs in the society. In today‘s international business environment, MNCs are judged by the social responsiveness shown to the needs of the community. The employment practices, bribery and corruption practices, human rights issues define the culture of the MNCs in host countries. Payments & gifts for securing business in some foreign markets are customary while in some markets it is considered as illegal.

(iii) Labour Issues of International Business

MNCs practices regarding wages and working conditions, working hours, health & safety issues in overseas locations always remain debatable even if the companies fulfil all the legal formalities because standards in some countries are high, looks somewhat unrealistic. An effective approach is to develop international company's standards which protects workers, provides good health & safety conditions, reasonable working hours which fit into the host country's local economy.

(iv) Environment Issues of International Business

MNCs are criticised for discharging harmful chemicals, gases into the environment just because of their malpractices to avoid costly anti-pollution measures. The expansion plans of the MNCs will be halted if company's operations have harmful effect in the surrounding population. It is ethical to adhere to the standards to protect environment in the host countries.

11.4.1 Globalisation

Globalisation is the shift towards a more integrated and interdependent world economy. The dependency of one nation on another has increased enormously. Globalisation is the integration of one nation's economy with rest of the others by opening up of the economy and liberalising the rules of foreign investment in the country. It involves creating a healthy socio-economic & political environment. IMF defines globalisation as ―the growing economic interdependence of countries worldwide through increasing volume and variety of cross-border transactions in goods and services and of international capital flows and also through the more rapid and wide spread of technology‖. Globalisation is the concept of self-contained countries to towards integrated world.

11.4.2 Globalisation of Businesses

There was a time when the customer had access to goods and services that were available locally. The tastes, preferences, choices were limited by what they could access on foot, by horse, or by carriage. However, with the rise of internet-based businesses like Amazon, Alibaba, Flipkart there's been an explosion of international trade, and more and more consumers essentially have the world at their door with unlimited and best choices.

Globalization is broader than international business and describes a shift toward a more integrated world economy in which culture, ideas, and beliefs are exchanged in addition to goods, services, and resources. Globalization implies that the world is like a village. As a result of innovations in transportation and communication technologies, people around the world can more readily connect with one another both virtually and geographically. Globalisation of business is the change in the business of a company in a nation to one that operates in many nations. The impact of globalisation on business can be placed into four broad categories: (i) Globalisation of Markets (ii) Globalisation of Production (iii) Globalisation of Investment (iv) Globalisation of Technology

(i) Globalisation of Markets

Globalisation of markets refers to the process of integration and merger of different global markets into a single market. It is because of decrease in the barriers and ease in restrictions helping companies to sell in overseas markets. It also means that companies must respect and consider the values & cultures of the host market while developing their business strategies and potentially adjust their marketing mix if they aren't appropriate in the target country. One of the reasons for globalisation of markets is the large scale industrialisation that leads to mass production and the companies started marketing their products and services in overseas markets to achieve profits & their goals.

Consider the examples of McDonald‗s Corporation (Headquarter in Chicago, United States), Domino‗s Pizza Inc., (Headquarter in Michigan, United States) Starbucks Corporation (Headquarter in Seattle, Washington, United States), while entering in India these companies had definitely need to revisit and to redefine their product & communication strategies to be successful in Indian market.

(ii) Globalisation of Production

Globalisation of production is locating the manufacturing facilities in a number of locations around the globe. The reason may be low costs inputs, high quality raw material, low cost labor, skilled human resource at low cost, reduced transportation cost, or nearness to the market. Globalization of production is also the sourcing of materials and services from other countries to gain advantage from price differences in different nations. This price differences will make the company to be competitive in international markets.

As for example, ―Harley-Davidson Inc. was founded in Milwaukee, Wisconsin in 1903 and having more than 6,000 employees worldwide. Harley-Davidson India is a wholly owned subsidiary of Harley- Davidson, based in Gurgaon, Haryana. It has its manufacturing plants at USA, Pennsylvania, York (Vehicle and Powertrain Operations), USA, Wisconsin, Menomonee Falls (Powertrain Operations), USA, Wisconsin, Tomahawk (Tomahawk Operations), Australia (Adelaide – New Castalloy), Brazil (Manaus –Harley-Davidson do Brasil Ltda Assembly Plant), India (Bawal, Rewari, Haryana – Harley-

Davidson India Bawal Assembly Plant), and Thailand (Rayong – Thailand Sales Office and

Assembly Plant)‖.

(iii) Globalisation of Investment

Globalisation of investment refers to the investment of capital by a global company in any part of the world. MNCs have to remain vigilant regarding the investment avenues as well as the investments of the competitors. Globalisation refers the way for the international organisations to have presence in overseas markets and start operations by investing in a number of ways.

The rise of globalisation has led more connections among financial markets and businesses around the globe and has generated many opportunities. There is no doubt that globalisation has influenced international investing and make the process of investment in foreign companies very fast. Now, companies can buy stocks, mutual funds, exchange-traded funds (ETFs), American Depositary Receipts (ADRs), and Global Depositary Receipts (GDRs) to gain access to the shares of internationally-based companies. As for example: US retail giant Walmart Inc picked up a 77% stake in India‘s largest online retailer Flipkart for $16 billion in May 2018.

(iv) Globalisation of Technology

The technological revolution has reached around the world, with important consequences for international companies. In the last two decades, there has been rapid improvement in the spread of technology among nations through MNCs. The technological progress and economic growth rates were linked. The rise in technological progress has definitely helped many nations improvements in incomes and standard of living. New technological innovations like digital technology, smart mobile phones, m- commerce, B2B, B2C, C2C e-commerce operations, mobile banking, computer-aided design, telecommunications, and other developments with various perspectives reach into business and trade. MNCs have to keep on tracking the latest developments in the technology all over the world. They have to equip themselves with the latest technology to remain competitive in the market which is again a very difficult task.

11.5 CHECK YOUR PROGRESS

1. What is Sole Source Negotiation?

    (A) The process for entering into or modifying a contract after soliciting and negotiating with only one source

    (B) The process for entering into or modifying a contract before soliciting and negotiating with only one source.

(C) The process for modifying a contract after soliciting and negotiating with only one source.

(D) The process for modifying a contract before soliciting and negotiating with only one source.

(E) None of the above.

2. There are 4 basic tactics when negotiating out of which one recognizes that the other party might have a position that meets the objectives of both parties?

(A) Deadlock

(B) Time

restriction (C)

Cooperative

(D) Competitive

3. What is the most important step in the negotiation process?

(A) Fact Finding

(B) Negotiation Objectives

(C) Preparation

(D) Setting Standards

4. Four basic tactics are the cooperative mode, competitive mode, deadlock, and time restrictions.

(A) Tr

ue

(B) Fal

se

5. What to do when you have a deadlock in negotiations?

(A) New objectives must be established.

(B) Demand that the other party accept your last position.

(C) Make the buyer's position look unreasonable and foolish.

(D) Start the "technical leveling" process.

6. What is the Competitive Range?

(A) A review to determine and evaluate the cost elements in an offeror's or contractor's proposal.

(B) The competitive range comprised of the most highly rated proposals.

(C) All proposals

submitted. (D) A and C.

(E) A and B.

State whether the following statements are true or false:

1) Facebook which is an American company holding almost 9.99% stake in Reliance Jio.

2) Globalisation means to do business only in domestic market.

3) Ethical issues are very important to follow in international business.

4) Intellectual property rights do not necessarily to follow in international business.

5) International business means to perform business activities on international level.

11.6 SUMMARY

A negotiation is a process of resolving an issue between two or more parties by strategically discussing in such a way that both parties find it acceptable.

An international business negotiation is the process of deliberate interaction of two or more parties where at least one of them a business entity originating from different countries. International business negotiations take place within a broader framework than domestic negotiations.

Process of negotiation consists of three different negotiation stages including the pre- negotiation, actual negotiation, and post- stages.

A negotiation outcome is the result of the negotiation process that is, the result of interaction between the partners. It includes partnership, contract, profit, winning, and the time expectations of the negotiation.

Different cultures have preference for a certain outcome

Culture provides the context for negotiation because it takes place within the framework of a culture‘s institutions and is influenced by its norms and values.

Important Issues in International negotiations are communication barriers and cultural barriers.

An international business negotiation is affected by several factors that make them more complicated than those conducted among companies within the same country. Others factors are Attitudes towards Risk, Government-Business Relations, Communication Style, and Corporate

Structure.

Preparations for negotiation are based on intelligence and negotiation research. The steps of the preparation of negotiations are 1.Consider the objective of negotiation, 2. Business Negotiators Organise Their Team, 4. Consider All the Options, 5. Know goals of negotiator and counterparty, 6. Identify the Issues, 7. Consider multiple proposals.

Major development in international business are because of globalisation and the impact of globalisation on business can be placed into four broad categories namely globalisation of markets, globalisation of production, globalisation of investments and globalisation of technology. Globalisation is the integration of one nation‘s economy with rest of the others by opening up of the economy and liberalising the rules of foreign investment in the country.

Globalization is broader than international business and describes a shift toward a more integrated world economy in which culture, ideas, and beliefs are exchanged in addition to goods, services, and resources. The impact of globalisation on business can be placed into four broad categories: (i) Globalisation of Markets (ii) Globalisation of Production (iii) Globalisation of Investment (iv) Globalisation of Technology

Most of the top management of international businesses have concerns regarding Social issues, Ethical Issues, Labour Issues, Environmental Issues, Legal & Regulation Issues, Cyber Security Issues, Geopolitical Uncertainty. The international managers must understand the issues in international business which may affect their role.

11.7 KEYWORDS

International Business Negotiation

An international business negotiation is the process of deliberate interaction of two or more parties where at least one of them a business entity originating from different countries to define or redefine their perspective and interdependence in a business matter.

Globalisation

Globalisation is the integration of one nation‘s economy with rest of the others by opening up of the economy and liberalising the rules of foreign investment in the country.

Ethics

Ethics are the moral principles that govern behaviour or the conducting of an activity and concerned with what is good for individuals and society.

11.8 SELF- ASSESSMENT TEST

Q.1 What do you mean by negotiation? How it affects the international business?

Q.2 Describe the process of negotiation and write down its outcome and performance in international business.

Q.3 Elaborate the preparation of business negotiation.

Q.4 How do you deal with cross cultural problem in international business negotiation?

Q.5 What are the major developments in international business? Elaborate.

Q.6 Write down the ethical and social responsibility issues of international business.

Q.7 What do you mean by globalization? Elaborate the different fields of globalisation.

Q.8 Explain important issues in international business.

Q.9 Discuss the recent developments in international business with suitable examples.

11.9 ANSWERS TO CHECK YOUR PROGRESS

(1) E

(2) C

(3) B

(4) A

(5) A

(6) E

True/False

(1) True (2) False

(3) True (4) False

(5) True

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