Master of Business Administration
(M.B.A.)

MBA-205

INTERNATIONAL BUSINESS

Directorate of Distance Education

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1.1 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, 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

1.2 Opening Case Study: Hyundai Motor India Ltd

The Hyundai Motor India Ltd is a South Korean multinational automotive manufacturing company headquartered in Seoul. Its annual production capacity is 1.5 million units and the company employs about 74,000 people worldwide. Hyundai motors sold cars in 193 countries through their well managed 4900 dealers across the world. Hyundai has two production plants located at Sriperumbudur, Tamil Nadu, India and Research & Development facility at Hyderabad. Hyundai Motors in India started its export in 1999 and exported 20 Hyundai Santro to Nepal. Thereafter, it exported 1 lakh cars in October 2004 and 1,81,000 cars in 2019. Hyundai has consistent performance in export since last 10 years and exports vehicles to over 92 countries across Africa, Middle East, Latin America, Australia and Asian countries successfully. Thus, the scope of the international trade is expanded into international marketing and international marketing is expanded into international business.

1.3 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.

1.4 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.

1.5 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, 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).

1.6 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.

1.7 Difference between International Business and Domestic 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.

1.8 The Growing Relevance of Globalisation

Globalisation is the process of interaction and integration among people, companies, and governments globally. Globalization has grown due to advances in modes transportation and communication technology especially internet. With the increased global interactions comes the growth of ideas, culture, trade and international business. The whole world is becoming like a village and companies are becoming more liberal and can access man, material, money, machine from any market of the world. Further, removal of cross-border trade barriers has made formation of global markets more feasible. Some of the benefits of globalization are foreign direct investment (FDI) which tends to increase at a much greater rate leads to technology transfer and growth of global companies. Globalization is making markets more efficient, increasing competition, sharing resources, and spreading wealth more equally. 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.

1.9 Factors Responsible for the Growth in Globalization of International Business

There has been growth in globalization in recent decades due to the following factors:

- Internet has reduced the cost of transmitting and communicating information
- Technology has made transportation and communications very fast.
- Governments are relaxing international business restrictions day by day.
- Services are expanding which are causing ease of doing international business.
- The lower costs of ocean shipping due to containerisation, bulk shipping, and other efficiencies.
- Consumers' interest is increasing in foreign goods and services.
- Competition has become more global.
- Governments are dismantling non-tariff protection such as import licensing

- Foreign exchange controls have gradually been relaxing.
- Political relationships have improved among some major economic powers.
- Countries cooperate more on transnational issues.
- Global businesses and brands have invested significantly in expanding internationally.
- Cross-national cooperation and regional agreements.

1.10 International Orientations (EPRG Framework)

EPRG stands for Ethnocentric, Polycentric, Regiocentric, and Geocentric. Different attitudes regarding company's involvement in strategic decision making are called international orientations. There are four international orientations adopted by the companies called EPRG Framework. EPRG framework was introduced by Wind, Douglas and H V Perlmutter in 1969. This framework addresses the way strategic decisions are made and how the relationship between headquarters and its subsidiaries is shaped. The EPRG Framework suggests that companies must decide which approach is most suitable for achieving successful results in countries abroad. EPRG framework orientations in the international operations evolution are discussed below:

- Ethnocentrism (home country orientation)
- Polycentrism (host country orientation)
- Regiocentrism (Regional orientation)
- Geocentrism (world orientation)

Ethnocentric Orientation

Ethnocentric is defined as the tendency of a firm to be largely concerned with its viability and legitimacy only in its home country. Management focus is to do in host countries what is done in the home country. The companies adopting or working in this way believe that home country is superior in nature and when they search for any opportunities in the international markets they tend to seek similarities with that of the home country. These companies are associated with attitudes of national arrogance and supremacy. The strategic actions of such companies are similar to domestic responses. This approach makes domestic companies vulnerable to changes forced upon them by foreign competition. The companies having ethnocentric approach hardly conduct any systematic research and study on the international markets to understand the foreign market in terms of customers' new or change in taste, preferences, choices, attitudes, behaviour etc. These companies make hardly any adaptations to their products to suit the taste and requirements of the new market that they are catering to.

- Products and processes used at home are used abroad without adaptation
- It is applied in domestic marketing and export marketing.
- It assumes products and services of home country are successful everywhere.
- It considers foreign operations as secondary.
- No systematic marketing research is done outside.
- Differences in needs and wants are ignored at headquarters.
- These companies are sometimes called an international company.

Polycentric Orientation

The companies following the polycentric approach covers market specific strategies (manufacturing at home & product development, branding, distribution, pricing, promotion abroad). These companies treat each country different and exclusive. They consider that the businesses are best run locally in the international markets. This approach provides a strong groundwork for its every subsidiary to develop its unique marketing and business strategies for success and the country's domestic market is given equal importance.

- Strong orientation towards the target markets.
- Independent foreign subsidiaries took place.
- It is applied in international marketing.
- Management operates under the assumption that every foreign market is unique; the company develops country-specific strategies.
- Each subsidiary has unique business and marketing strategy.

- These types of companies are sometimes called a multinational company.
- Company operates differently in each host country based on that country's environment
- It is like opposite of ethnocentrism.

Regiocentric Orientation

In a regiocentric approach of the EPRG Framework, businesses create and implement internationalization strategies for specific regions. Markets are divided into regional sub-segments on the basis of their similarity to respond to marketing mix decision.

- Management orientation is geared to developing an integrated regional strategy.
- It is applied in Multinational Marketing.
- The management believe that the region are the relevant geographic unit (rather than by country)

Geocentric Orientation

Geocentric approach encourages global marketing. It is globalization of marketing mix decisions. According to this approach, entire world is a potential market and Global companies serve world markets from a single country and tend to retain association with a headquarters country.

- It is applied in Global Marketing.
- Management philosophy is to develop integrated world market strategies.
- The companies that serve global markets and acquire resources globally are called Transnational Companies.

1.11 Risks in International Business

- Strategic risk
- Operational risk
- Political risk
- Technological Risk
- Environmental Risk
- Economic Risk
- Financial risk

- Terrorism Risk
- Planning risk
- Currency risk

1.12 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.

1.13 Importance of International Business Education

- An understanding of international business education helps to make better career decisions and to learn the best way of conducting business in different countries.
- An understanding international business helps to decide what and how government policies to support and how in international market, different modes of operation may differ from domestic market.
- An understanding of international business education helps to understand that maximum of the companies are either international or compete with international companies.

1.14 Case Study: Dabur India Ltd

Dabur India Ltd is an Indian consumer goods company founded in 1884 by S. K. Burman. Its products are health supplements (Dabur Chyawanprash, Dabur Honey, Dabur Glucose), digestives (Dabur

Hajmola), skin care (Dabur Gulabari), hair oil, oral care, ayruvedic medicine, Foods (Real Juice) and natural consumer products. Dabur has 11 manufacturing facilities in India, out of which two main units are at Baddi (Himachal Pradesh) and Pantnagar (Uttaranchal). Dabur was ranked 45th among India's most trusted brands according to the Brand Trust Report 2013. Dabur India Limited Q3 net up 15.7% on strong volume because of international business. The company had posted net profit of Rs 210.5 crore in the same period of 2012-13 fiscal (January 22, 2014). Dabur India Ltd posted 8.62 per cent increase in consolidated net profit at Rs 398.87 crore for the third quarter ended December 2019.

International Footprints of Dabur India Limited:

- International business grew 26% and there is an increase in sale in markets like Gulf Cooperation Council (GCC), Egypt and Nigeria.
- Dabur India Ltd's have 17 factories spread across India and abroad where the manufacturing of various consumer products categories are carried out.
- Dabur's mission of popularising a natural and healthy lifestyle surpasses national boundaries. The company is lifting the benefit of growing global awareness on alternative medicine, nature-based products and holistic lifestyles and an interest in herbal products.
- Dabur has been marketing its products in more than 60 countries all over the world and has taken front position of popularising the healthy way of life,
- Over the years, Dabur's overseas business has successfully transformed from being a small operation into a multi-location business spreading through the Middle East, North Africa, West Africa and South Asia.
- Dabur has spread wide and deep to be close to its overseas consumers. Its overseas product portfolio is adapted to suit the needs and aspirations of growing consumer base in the international markets of Europe, UK, America and Africa. At present, the comapny has its offices in Dubai (UAE), Egypt, Bangladesh, Nigeria, London, United States, and Nepal.
- Dabur is selling a special herbal health care and personal care range successfully in global markets ranging from the Middle East, Far East, North Africa and Europe.

- Dabur inroads into several American markets that have good potential due to resurgence of the back-to-nature movement and acquired US based Namaste Laboratories LLC strategically & its three subsidiary companies for $100 million in an all cash deal. The deal marked Dabur's entry into the $1.5 billion ethnic hair care products market in the US, Europe and Africa.
- Dabur exports food and textile grade natural gums, extracted from traditional plant sources in international markets.
- The company have strategic partnerships with leading multinational food and health care companies to introduce innovations in products and services. Six modern manufacturing facilities are located across South Asia, Middle East and Africa to optimise production by utilising local resources and the most modern technology available

Dabur India Limited: International Footprints

1.15 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.

1.16 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.

1.17 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.

1.18 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.

1.19 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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Subject: International Business	
Course code: MBA-205	**Author: Dr Vijender Pal Saini**
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International Business Environment and Factors leading to growth in IB

STRUCTURE

2.1 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

2.2 Opening Case : Tupperware Brands Corporation

Tupperware Brands Corporation is a US based company having business that develops, manufactures and internationally distributes home products line. The company offers products exclusively for preparation, storage, and serving products for the kitchen and home. Home products line includes preparation, storage and serving products for kitchen and home. Earl Tupper developed his first bell shaped container first time in 1942. The company's headquarter is in Orlando, USA. The company was awarded 'America's Best Big Companies List' six times in a row in 2009 for high quality, lightweight, rust and break-proof, colourful, airtight, stylish containers. The company won 'Red Dot Award' in 2009, an award for excellence in product design, Germany. In 2013, the top marketplace of Tupperware was Indonesia, and second place was Germany. Indonesia's sales in 2013 were more than $200 million with 250,000 sales persons.

Tupperware India Pvt. Ltd is a wholly owned subsidiary of the US based Tupperware Brands Corporation. Tupperware started its operations in 1996 in India. The purpose of the company is to "inspire women to cultivate the confidence they need to enrich their lives, nourish their families, and fuel communities around the world." The vision of the company is to "ignite a global community, especially women, to realize their best selves through opportunity, enrichment, celebration, and above all else, uplifting relationships. We are committed to accelerating profitable revenue growth for the benefit of all our stakeholders”. The company had grown 12 per cent annually from 2003 to 2008 in India. The company faced problems at two fronts in Indian market, first, related with middle class Indian women’s buying behaviour (the case of Socio-Cultural Environment) and second, the cut-throat competition from local players in the market (the case of Competition Environment).

The company had to struggle to get sale from country’s middle class families segment as Indian women preferred to use metal containers to store leftover. The company had to work hard to convince millions of homemakers and create a market for nonmetal kitchenware. But the company kept on adapting its products to cater to local food habits. For example, Tupperware modified the rectangular containers for bread and produced round containers to accommodate the shape of roti (traditional Indian bread). Similar is the case of ‘masala box’ and ‘multicook’ products. Tupperware achieved its growth story by product localization via design and renovation in Indian market. The company faced competition from local players which leads to reconsider company’s business model and manage costs by adapting their product mix, raw materials, and packaging.

Tupperware Brands Corp now plans to open 100 stores in India during 2020. Globally, India is the 16th largest market by revenue for Tupperware Brands. Since 1996 in India, Tupperware products were sold through salesmen who went door-to-door for over two decades. In July 2019, the company opened its first India store (brick-and-mortar retail format) in Delhi. Since then, it has opened 50 more outlets in Mumbai, Pune, Bengaluru, Amritsar, Jaipur, and Patna, among other cities in less than six months. The main reason of strategic decision (direct sale or door-to-door to Retail Sale) of opening stores in India is the change in the Indian business environment as India is facing slowdown in this duration. Now, the company’s sale strategy is both online (click-and-mortar retail format) as well as offline (retail stores) in Indian market. There is a boom of online platforms / e-commerce in Indian market. The company is planning to add 100 more outlets here by the end of this year, taking its total count to 150 as part of its expansion plans. All the stores would come on the franchise model.

2.3 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.

2.3.1 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

2.3.2 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.

2.3.3 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.

2.3.4 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.

2.3.5 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.

2.4 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.

2.5 Closing Case : Kentucky Fried Chicken (KFC)

KFC was opened by Colonel Harland Sanders in Salt Lake City, Utah, US in 1952. KFC was one of the first fast-food chains in chicken segment/fried chicken to expand internationally. It opened its outlets in England, Mexico, and Jamaica by the mid-1960s. KFC had become the sixth largest restaurant chain in the US by sales volume by 1967. The American fast food chain has expanded to 18,875 outlets across 150 countries and territories. It has 4,563 outlets in China alone which is KFC's largest market, the United States (4,020 outlets), Japan (1,181 outlets), the United Kingdom (900 outlets), South Africa (736 outlets), Malaysia (701 outlets), Canada (663 outlets), Australia (618 outlets), Russia (608 outlets), and Thailand (531 outlets) in early 2020. KFC became the first American fast food chain to enter the Chinese market when it opened its first restaurant just a short walk from Beijing's famous Tiananmen Square in 1987.

KFC is the world's most popular American Fast Food Chain. KFC is one of the companies that expanded international business very successfully. It identified the likes and dislikes at the local and cultural level successfully. It served food according to Chinese taste. The company offers larger dishes for sharing as the Chinese have a culture to eat in groups. KFC opted different strategies in China than their home country by providing large menu with new products offerings like egg tart, vegetable soup, hot breakfast for office workers and shrimp burgers to match the customer preferences. The company hired managers who can speak and write Chinese language and heavily invested in employees' training to provide world class services to the Chinese customers. KFC develops transportation system and storage network to control the quality of products and services in China. The company redesigned product packaging, and started digital initiatives like mobile apps, e-menu and prepay take-out options.

The company opened its first store in India in a two-storey outlet in Bangalore in 1995. The first outlet suffered protests from anti-globalisation and environmentalists and local farmers, who objected to the fast food chain for bypassing local producers. The protests came to a head in August 1995, when the Bangalore outlet was repeatedly ransacked. The outlet was closed on September 13, 1995 by local authorities, who claimed the company used illegally high amounts of monosodium glutamate (MSG, a flavor enhancing substance) in its food. A second outlet was opened in Delhi, but was closed by the authorities for health reasons. The Delhi outlet soon closed permanently. The company faced severe protests from an animal rights protection organisation. The company started to expand its business again in 2004 by providing localized meat-free menu vegetarian menu that included rice meals, wraps and side dishes. KFC operated 34 outlets in India In 2014 and launched "So Veg, So Good" menu as part of an India-specific promotional strategy focused on enhancing their vegetarian range. At present, KFC has strong presence with 350 KFC outlets around 1000-1500 square feet spread across different parts in India. The company has adapted the standard KFC offerings to Indian taste and the menu options in India include the Veg Zinger Burger, Hot & Crispy Chicken and Fiery Grilled bucket options, Chicken Zinger, Krushers, Rice Bowlz and the more recently launched 5-in-1 Zinger Burger Meal Box.

2.6 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_______________.

2.7 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.

2.8 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.

2.9 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?

2.10 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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Subject: International Business	
Course code: MBA-205	Author: Dr Vijender Pal Saini
Lesson no. : 03	Vetter: Prof. Pardeep Gupta

Modes of International Business

STRUCTURE

3.1 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

3.2 Opening Case: Tata Group

Tata Group is one of the India's largest conglomerates with many subsidiaries and joint venture companies, headquartered in Mumbai, Maharashtra, India run by Tata Sons. The Tata Group was founded as a private trading firm by entrepreneur and philanthropist Jamsetji Nusserwanji Tata in 1868. His son Sir Dorab Tata took over as chairman of the Tata Group after Jamsetji's death in 1904. Sir Nowroji Saklatwala became the group's chairman in 1932. Six years later, Jehangir Ratanji Dadabhoy Tata (J.R.D.) took over the position. Ratan Tata took over as chairman of the Tata Group in 1991. Tata Sons Limited is the holding company of the Tata Group. It holds the bulk of shareholding in these companies. Tata Sons is the principal investment holding company and promoter of Tata companies. It is the owner of the Tata name and the Tata trademarks, which are registered in India and several other countries. Each Tata company operates independently under the guidance and supervision of its own board of directors and shareholders.

Some of the significant subsidiary companies and joint venture companies of Tata Group are as following: Tata Consultancy Services Ltd (TCS)- IT services, consultancy and business solutions provider, Tata Motors Limited - automobile manufacturers, Tata Consumer Products Ltd. (formerly known as Tata Global Beverages Limited)– tea, coffee business, Tata Steel Limited – steel manufacturing company, Tata Chemical Limited – chemicals and salt manufacturing, Titan Company Ltd- watch and jewelry manufacturing company, Tata Power Company Limited – power & renewable energy, Tata Communication Limited, Voltas Limited-air conditioning company, Trent Limited - retail industry, Tata Elxsi limited- design and service provider. Tata Consultancy Services Ltd posted Rs. 23,075.00 crore net profit in 2016, and Rs. 33,260.00 crore net profit in 2020.

Ratan Tata aggressively expanded the business as he focused on globalisation of its businesses after assuming the chairmanship of Tata Group. Tata group’s Tata Tea company acquired the UK-based Tetley's (founded 180 years ago) global operations for Rs 1,870 crore (£ 271 million) in 2000. It was one of the largest overseas acquisitions by an Indian group, Tata Group. This acquisition made the company to face tough competition with global giants like Unilever and Nestle. Tetley brand provided global opportunity to the company. Tata tea got the opportunity in the global markets like UK, US, Canada, Australia and Europe after acquisition of Tata Tetley.

Tata Global Beverages Ltd and Starbucks Coffee Company (American multinational chain of coffee houses, serves hot and cold drinks, headquartered in Seattle, Washington, operates 30,000 locations worldwide in over 77 countries in 2020) had a 50:50 joint venture (JV) called Tata Starbucks Ltd to lift the opportunity of the growing hot beverages market in India in 2012. The Tata Starbucks Ltd. planned to operate 50 Starbucks cafes across India starting from Delhi and Mumbai. The company got the strengths to compete with Costa Coffee, Cafe Coffee Day and Barista in India.

Tata Group partnered with American International Group, Inc. (AIG) to create the insurance company Tata-AIG in 2001. It acquired the truck-manufacturing operations of South Korea’s Daewoo Motors in 2004. Tata Steel completed the biggest corporate takeover by an Indian company when it acquired the giant Anglo-Dutch steel manufacturer Corus Group in 2007 ($12 billion deal). Tata Motors acquired the elite British brands Jaguar and Land Rover from the Ford Motor Company in 2008 (US $2.3 billion).

3.3 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.

3.4 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.

3.5 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)

3.5.1 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.

3.5.2 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.

3.5.3 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.

3.6 Closing Case: Dr. Reddy's Laboratories Limited

Dr. Reddy's Laboratories Limited is a multinational pharmaceutical company based Hyderabad, in India founded by Anji Reddy. Dr. Reddy's manufactures and markets a wide range of pharmaceuticals in India and overseas. It is an integrated global pharmaceutical company committed to providing affordable and innovative medicines for healthier lives in well diversified across India, US, Emerging markets & Europe. The company made their beginning with the manufacture of Active Pharmaceutical Ingredients and Intermediates (API) and commenced operations with a single drug in a 60-tonne facility near Hyderabad India. The company is amongst the leaders in supply of generic APIs globally. The company reported global revenues of $2.4bn in financial year 2015. The company's branded generic markets are India, Russia (entry in 1991), Commonwealth of Independent States **(**CIS, Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan), Venezuela and others while the company's generic markets are USA, UK and Germany. The company has R&D centers in India, UK, Netherlands and US with more than 1200 scientists involved in process & product innovation. In the year 2002, the company made their first overseas acquisition of BMS Laboratories Limited and Meridian Healthcare in UK. The company took-over Roche's Mexico plant in $59 million in late 2005. The company announced in February 2020 to acquire the select divisions of branded generics in Wockhardt Ltd. (Wockhardt Ltd. is a Indian global company (as more than half of its revenue come from Europe) dealing in pharmaceutical and biotechnology, headquartered in Mumbai, India. The company has manufacturing plants in India, UK, Ireland, France and US, and subsidiaries in US, UK, Ireland and France.) Dr Reddy's acquired 62 brands from Wockhardt related with respiratory, neurology, VMS (Vitamins, Minerals & Supplements), dermatology, gastroenterology, pain and vaccines. This acquisition will boost Dr Reddy's international operations and investments in biosimilars for the US market. The company reported net profit in Rs. 1354.50 crore in 2016 and posted Rs. 2937.70 crore net profit in 2020.

3.7 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.

3.8 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.

3.9 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.

3.10 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.

3.11 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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Lesson no. : 04	Vetter: Prof. Pardeep Gupta
An overview of International Trade Theories	

STRUCTURE

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4.1 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

4.2 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:

4.2.1 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.

4.2.2 Absolute Advantage Theory

Absolute Advantage Theory was given by Adam Smith (Wealth of Nations, 1776) in 17th 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.

4.2.3 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.

4.2.4 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.

4.2.5 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.

4.2.6 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.

4.2.7 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

4.2.8 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

4.3 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".

4.4 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.

4.5 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.

4.6 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.

4.7 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

4.8 References / Suggested Readings

- Aswathappa, K. *International Business*, McGraw Hill Education, (India) Private Limited, New Delhi.

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Subject: International Business	
Course code: MBA-205	Author: Dr Vijender Pal Saini
Lesson no. : 05	Vetter: Prof. Pardeep Gupta

Commercial Policy Instruments: Tariff and Non-Tariff Measures and their Impact

STRUCTURE

5.1 Learning Objectives

Trade barriers are imposed to keep and regulate firms from selling to one another in foreign markets. The objective of this chapter is to get the students acquainted with the types of trade barriers imposed to keep and regulate firms from selling to one another in foreign markets. The students will learn why are the trade barriers obstacles in the way of smooth international trade?

After reading this chapter, students will be able to:

- Describe the concept of trade barriers in international business
- Understand outward trade policy and inward trade policy
- Explain different types of tariff and non-tariff barriers
- Elaborate the rationale behind the barriers imposed by nations

5.2 Opening Case: Cheaper Cement from Pakistan Shakes Domestic Industry

"Hit by cheaper cement imports from Pakistan, domestic manufacturers, particularly cement units based in Himachal Pradesh and Punjab, have demanded immediate tariff and non-tariff protection against the dumping from across the border.

Domestic cement manufacturers are facing a glut because of imports from Pakistan, rendering their capacity idle, industry executives said. According to an industry estimate, the country's current unutilised cement capacity is around 100 million tonnes.

A cement major, which has units in Punjab and Himachal Pradesh, could utilise only 75 per cent of its capacity, said a company executive requesting anonymity. Against a demand of about 8 million tonnes per annum in Punjab alone, imports are as high as 1.5 million tonnes, the executive added. An official data showed an unprecedented 24 per cent growth in imports in just one quarter ending March 2018.

"The (Indian) industry had built capacity in anticipation of increased demand due to the impetus given to housing and infrastructure sectors. The demand scenario, however, remains subdued," said an executive of a Himachal Pradesh-based cement unit. The state has a presence of major cement manufacturers such as Ambuja Cements, Ultra Tech and ACC. Pakistan exporters are resorting to predatory pricing, executives said. While cement is sold in Pakistan at $100 per metric tonne, it is dumped in India at $63-65 per metric tonne, they added.

Table 5.1 Islamabad Enjoys Lion's Share (in Metric Tonne)

Year	Total Imports	Imports from Pakistan	Imports Percentage
2013-14	662,795	476,672	72

2014-15	1,022,016	791,520	77
2015-16	1,098,224	858,272	78
2016-17	16,89,310	14,52,506	86

India is Pakistan's second largest export market for cement after Afghanistan, which allows imports without basic customs duty since 2007. Pakistan, however, imposes 11 per cent duty on imports from India, the industry experts said.

Pakistan's cement export to India has become more aggressive after it is losing its grip in the Afghanistan market due to intense Iranian competition, experts said.

The unbridled import from Pakistan to India would hamper the domestic industry, which is also against the spirit of 'Make in India', Indian cement manufacturers said adding that the impact of the dumping is spreading in other parts of the country.

Manufacturers are demanding a level-playing field by imposing an 11 per cent customs duty, besides other levies. They have also suggested capping of entry points and ports for cement imports into India as additional safeguards against the dumping". (Source: The Tribune, Ambika Sharma, Cheaper Cement from Pakistan Shakes Domestic Industry, Tribune News Service, Solan, September 11, 2018)

5.3 Introduction: International Business Trade Barriers

Since the inception of civilization the countries are indulged in trade with each other. Every country in the world has their trade policies for international trade. Foreign trade policies are made to regulate the trade across the boundaries. In general, trade barriers are imposed to keep and regulate firms from selling to one another in foreign markets. Trade barriers are obstacles in the way of smooth international trade.

Foreign Trade policies of different countries can be classified as (i) Free trade/Outward-oriented and (ii) Fair trade/ Inward trade.

i) **Free Trade Policy/Outward Trade Policy**

It implies that the government of the land exerts minimal influence on decisions relating exports or imports made by private individuals and businesses. This concept was first given by Adam

Smith, which implies that the government interventions in market activities, import and export, etc., should be nil. However, the government is also necessary, as suggested by Keynes, in his modern theory of consumption. Therefore, outward-oriented policy implies that the government of the country observes minimum influence on decisions related to exports or imports in the country.

The following reasons supports the free trade policy:

- Free trade promotes world trade.
- Free trade means free trade/exports-import and it means more jobs.
- Consumer is the king and therefore be provided with best and variety of products and services;
- World trade should be promoted for better and efficient utilization the global resources;
- Global competition forces companies to become more efficient and innovative; and
- World trade motivates most efficient companies to exist and less efficient companies exit.

ii) **Fair Trade / Inward-Oriented Policy**

This policy suggests that the government of the land should actively intervene in export and import. It ensures that exports from the own country receive a fair share in the global trade and that imports are controlled. Fair trade / Inward-Oriented policy emphasis on government intervention in market activities. It suggests that the government of the country should actively intervene in market forces and make ensure that exports made by it are receiving a better consideration in global trade and its imports are controlled and managed. The ultimate purpose is to minimise losses of domestic jobs and market share in specific industries or weak industries. Therefore fair trade / inward-oriented policy is also known as Managed Trade Policy.

5.4 Barriers to International Trade

The countries which adopt the inward trade policy usually impose many restrictions over their trade with other countries. The barriers are generally imposed to protect domestic industries from global competition. The trade barriers are classified into tariff and non-tariff strategies:

5.4.1 Tariff Barriers

A tariff is a tax imposed on goods traded among countries, particularly on imported goods. It may be a imposed on per unit of goods, i.e., per barrel of oil or per new car. It may be in the form of percentage of the value of the goods, such as 5 percent of a Rs 50,000 shipment of shoes; or it may be a combination of both. Tariff makes imported goods more costly so that they become less able to compete with domestic companies

Types of tariff barriers:

i) **Import duty**

Tariffs which are imposed by destination country on goods which are being imported are called import duties. It is also known as custom duty, import tax or import tariff.

ii) **Export Duty**

Taxes imposed by origin country on goods which are being exported are called export tariff.

iii) **Transit Duty**

When taxes are imposed on goods which are passing through another country another than, origin country or destination country are called transit tariff.

iv) **Specific Duty**

Specific tariff is the tax which is imposed on some specific attributes of goods – weight, quantity, value and the like per unit, measurement of the product being imported or exported.

v) **Ad Valorem Duty**

An ad valorem duty is a tax based on the total value of an item. It is imposed on the price value of commodity.

vi) **Compound Duty**

It is a combination of specific duty and an ad valorem duty. It is levied and is calculated partly as a percentage on value and partly as a rate per unit or weight.

5.4.2 Non-tariffs Barriers

A non-tariff barrier is qualitative method of imposing restrictions. It includes generally restrictions which are in the form of quotas, subsidies, voluntary export restraint (VER), local content requirement, foreign exchange control and embargo etc.

(i) Quotas

Quotas refer to numerical limits on the quantity of goods that may be imported into a country during a specific period. Under quota system, the number of items to be imported for a specific period by a country is decided and import of more than that limit is not permissible. Quantity is stated in license. Penalty is imposed if violated. Quotas seem to be quantitative restrictions because it is imposed on imports and exports of a specific product for a specified period. Generally Countries use quotas as directive forms of administrative regulations of international trade.

(ii) Subsidies

Subsidies are the payments provided by government to domestic producer of the country. It may be in the form of cash payment/grants, concessional loans, deductions in taxes and government equity participation in local firms. It provides assistance to domestic producers to compete against low cost foreign goods and helps in gaining access to export markets.

(iii) Voluntary Export Restraint (VER)

A voluntary export restraint (VER) is a trade restriction that is generally imposed on goods being exported by the country. It is kind of limit self-imposed by the exporting country.

(iv) Local content requirement

Local content requirements are the concept of de globalization, which are the policies imposed by governments that require firms to compulsorily make use of domestically-manufactured goods in the products.

(v) Foreign Exchange Control

Foreign Exchange Control is a method of intervention by government to correct the adverse balance of payments. Here the government intervenes with free flow of capital and the foreign exchange.

(vi) Embargo

Embargoes are defined as complete prohibition or bans of trade of specific commodities and may be imposed on imports or exports of specific goods that are supplied to or from specific countries. Generally it is imposed in the time of wars.

It can be said that trade barriers make trade restrictive among countries. Each country has its own objective to impose trade barrier(s). Different institutions are developed over the time to regulate and liberalize trade barriers and to make free global trade like World Trade Organisation (WTO).

5.5 Check Your Progress

1. The most common trade barrier faced by a multinational company is the:

(A) Embargo (B) Quota

(C) Sales Tax (D) Tariff

2. In international trade which of the following is a non-tariff trade barrier?

(A) Quotas (B) Import bans

(C) Export controls (D) Anti-dumping laws

3. Additional tariff levied on imported product on the notion that it is sold internationally at a price below cost.

(A) Ad valorem duty (B) Specific duty

(C) Anti-dumping duty (D) Countervailing duty

4. It is tariff imposed on the basis of both the value and quantity.

(A) Ad valorem duty (B) Specific duty

(C) Compound duty (D) Countervailing duty

5. The Import duty, specific duty, ad valorem duty, compound duty and countervailing duty are examples of:

(A) Currency controls (B) Tariffs barriers

(C) Administrative delays (D) Non-tariff barriers

6. The customs valuation, subsidies, special fee, quota, embargo and technical barriers are examples of:

(A) Tariffs barriers (B) Currency controls

(C) Administrative delays (D) Non-tariff barriers

7. A tax of 20 percent per unit value of imported good is an example of:

(A) Specific tariff (B) Nominal tariff

(C) Ad valorem tariff (D) Compound tariff

Fill in the Blanks

8. Full ban of export and import of one or more products with a particular country is called ________________.

9. ________________is a limit on the amount of a specific product that can enter a country.

10 Tariff duty levied on the basis of the value of the item is called ______________ .

11Tariff collected by a country through which the goods have passed, they are_______ .

12.Tariff duty imposed on the basis of both the value and quantity____________.

State whether the following statements are True or False

13. The use of anti dumping measure as an instrument of fair competition is permitted by the WTO.

14. Non-tariff Barriers are directly affect prices of imported product.

15. When the goods are exported at a price above the cost of production or those prevailing in the domestic market is called dumping.

16. Tariffs collected by the exporting countries are called export tariffs.

5.6 Summary

In general, trade barriers are imposed to keep and regulate firms from selling to one another in foreign markets. Trade barriers are obstacles in the way of smooth international trade. Foreign Trade policies of different countries can be classified as (i) Free trade/Outward-oriented and (ii) Fair trade/ Inward trade.

The trade barriers are classified into tariff and non-tariff strategies:

A tariff is a tax imposed on goods traded among countries, particularly on imported goods. Tariffs which are imposed by destination country on goods which are being imported are called import duties. It is also known as custom duty, import tax or import tariff. Taxes imposed by origin country

on goods which are being exported are called export tariff. When taxes are imposed on goods which are passing through another country, another than origin country or destination country are called transit tariff. Specific tariff is the tax which is imposed on some specific attributes of goods – weight, quantity, value and the like per unit, measurement of the product being imported or exported. An ad valorem duty is a tax based on the total value of an item. It is imposed on the price value of commodity. It is a combination of specific duty and an ad valorem duty. It is levied and is calculated partly as a percentage on value and partly as a rate per unit or weight.

A non-tariff barrier is qualitative method of imposing restrictions. It includes generally restrictions which are in the form of quotas, subsidies, voluntary export restraint (VER), local content requirement, foreign exchange control and embargo etc. Quotas refer to numerical limits on the quantity of goods that may be imported into a country during a specific period. Under quota system, the number of items to be imported for a specific period by a country is decided and import of more than that limit is not permissible. Subsidies are the payments provided by government to domestic producer of the country. It may be in the form of cash payment/grants, concessional loans, deductions in taxes and government equity participation in local firms. A voluntary export restraint (VER) is a trade restriction that is generally imposed on goods being exported by the country. It is kind of limit self-imposed by the exporting country. Local content requirements are the concept of de globalization, which are the policies imposed by governments that require firms to compulsorily make use of domestically-manufactured goods in the products. **Foreign Exchange Control** is a method of intervention by government to correct the adverse balance of payments. Here the government intervenes with free flow of capital and the foreign exchange. Embargoes are defined as complete prohibition or bans of trade of specific commodities and may be imposed on imports or exports of specific goods that are supplied to or from specific countries. Generally it is imposed in the time of wars.

5.7 Keywords

Tariff Barriers

A tariff is a tax imposed on goods traded among countries, particularly on imported goods may be per unit of goods or may be in the form of percentage of the value of the goods.

Non-tariffs Barriers

A non-tariff barrier is qualitative method of imposing restrictions in the form of quotas, embargoes, sanctions, and levies etc.

5.8 Self- Assessment Test

Q.1 Write a note on the instruments used by the government to control trade.

Q.2 What are the reasons for government‘s involvement in business?

Q.3 Elaborate the barriers in smooth way of international trade.

Q.4 What do you mean by tariff barriers in international trade? Write a detail note on it.

Q.5 Enumerate and describe the non-tariffs barriers in detail.

Q.6 Write short note on the following topics:

(i) Free Trade Policy/Outward Trade Policy

(ii) Fair Trade / Inward-Oriented Policy

5.8 Answers to Check Your Progress

(1) D	(2) B
(3) C	(4) C
(5) B	(6) D
(7) C	(8) Embargo
(9) Quota	(10) Ad valorem Duty
(11) Transit tariffs	(12) Compound Duty
(13) True	(14) False
(15) False	(16) True

5.10 References / Suggested Readings

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Subject: International Business	
Course code: MBA-205	Author: Dr Vijender Pal Saini
Lesson no. : 06	Vetter: Prof. Pardeep Gupta

Balance of Payment Account, Foreign Direct Investment and International Financial Environment

STRUCTURE

6.2 Learning Objectives

The objective of this chapter is to get the students acquainted with the basic concept, of Balance of Payment Account, Foreign Direct Investment and International Financial Environment.

After reading this chapter, students will be able to:

- Describe the concept of types and importance of BOP
- Explain the meaning, purpose, advantages, disadvantages of FDI
- Understand the constituents of International Financial Environment
- Importance of studying International Financial Environment

6.2 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.

6.3 Introduction: Balance of Payment

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 payment is a method used by a country to record and monitor all the international monetary transactions with the other countries for one year. BOP helps to determine how much money is going in and out of a country. In BOP, all the transactions made by governments, companies and individuals are recorded. It is the official record of funds flow in and out of country which helps in economic policy formation. The systematic accounting is done on the basis of double entry book keeping system. Theoretically, all the assets and liabilities must be zero but in reality, it does not happen. The Balance of Trade (BOT) of a country refers to the difference in how much a country is importing versus exporting. According to the RBI, balance of payment is a statistical statement that shows:

- The transaction in goods, services and income between an economy and the rest of the world,
- Changes of ownership and other changes in that economy's monetary gold, special drawing rights (SDRs), and financial claims on and liabilities to the rest of the world, and
- Unrequited transfers.

6.3.1 Types of Balance of Payment

(i) Favourable Balance of Payment

It is a condition when the payments received by a country are more than the payments the country has had to make. It is the condition of favourable/surplus BOP.

(ii) Unfavourable Balance of Payment

It is a condition when the payments made by the country exceed payments received by the country. This is also termed a balance of payments deficit.

Components of Balance of Payment

(i) Current 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. A current account deficit is a condition when a country's residents spend more on imports than they save. If the current account deficit continues for a long time, it will slow economic growth. In this scenario, foreign investors will hamper investments in the country as they will doubt about the return on their investments.

(ii) Capital Account

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.

6.3.2 Importance of Balance of Payment

i) The components of the balance of payments namely; the current account, and capital account help to access the strength and weaknesses of the economy in international relations.

ii) BOP helps economic policy makers to frame a suitable policy for the country. BOP statements gives signals to policy makers.

iii) Balance of trade indicates the difference between export and import and the long-term rising deficit indicates inflation and a lower standard of living for a country.

iv) By analyzing the BOP accounts of the last year one can come to know the overall gains and losses from international trade. It can be ascertained that whether composition and direction of international trade and capital movements have improved or caused deterioration in the economic condition of the country.

v) BPO statements give warning signals like payment imbalances, out flow of foreign direct investments, etc.

vi) The impact of government policies are reflected in BOP data.

6.4 Meaning of Foreign Direct Investment (FDI)

A **FOREIGN DIRECT INVESTMENT** (**FDI**) is an investment made by a firm or individual in one country into business interests located in another country. It is an investment in the form of a controlling ownership in a business in one country by an entity based in another country. 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/controlling ownership or starting production/expanding operation of an existing business in that country with the intention of establishing a lasting interest. Lasting interest differentiates FDI from Foreign Portfolio Investments/FII, where investors passively hold securities from a foreign 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.

6.4.1 Purposes of FDI

- The multinational companies invest in foreign market to acquire natural resources.
- Maximum of multinational companies spend huge amount on funds on R&D. The foreign market is the best option to recover of large expenditure made on research and development.
- The companies are able to capture a large segment of international market.
- Earning large profits and FDI improves balance of payment position.
- FDI helps in obtaining foreign exchange resources.
- FDI helps in developing managerial capabilities.

6.4.2 Sector of FDI in India

- Hotel and Tourism Industry
- Electricity Sector
- Construction Sector
- Insurance Sector
- Trading Sector
- Banking Sector
- Communication Sector

6.4.3 Benefits of FDI

- FDI increases employment and improve employees' efficiency.
- FDI brings financial resources for economic development.
- FDI improves the quality of products and services.
- FDI helps in resource transfer and market diversification.

- FDI helps in transfer of technology.
- FDI contribute to corporate tax revenues.
- Host countries are benefited with the access to new technology, management knowledge, expertise and skills.
- FDI is typically a long term commitment as the result of strategic decisions 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.

6.4.4 Disadvantages of FDI

- MNCs may exploit the labour and natural resources if there is no proper regulatory system in the country.
- The country or industry that attracts foreign investment may become entirely dependent for growth and increase the risk.
- 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 chances of large capital outflows from the host country if the MNCs are not going to reinvest profits back.
- There is a chance of rise in inflation.

6.4.5 Types of FDI

Horizontal FDI: Horizontal FDI arises when a firm duplicates its home country based business activities in foreign market. The company does all the same activities abroad as at home through FDI.

Platform FDI: The company expands its operations in host country through foreign direct investment for the purpose of a exporting to a third country is called platform FDI.

Vertical FDI: In vertical FDI, different types of activities are carried out abroad. It takes place when a company moves upstream or downstream in different value chain in global market through FDI. In case of forward vertical FDI, the FDI brings the company nearer to a market, i.e., the company takeover the distributorship in host market. In case of backward Vertical FDI, the international integration goes back towards raw materials, i.e., the company gets majority stake in a supplier business.

Conglomerate: In this type of investment, the investment is made to acquire an unrelated business in host country. In these types of FDI, the challenges as well as risks are more as the company is going to start new and unrelated business abroad.

6.4.6 FDI in India

Indian government opened up its economy in 1991 and liberalised, privatised and globalised (LPG) Indian economy for foreign direct investments. FDI investment climate in India has improved tremendously and FDI norms are eased regularly since 1991. Many sectors have opened up for foriegn investment partially or wholly since the economic liberalization of the country. In 2019, India was among the top ten receivers of FDI, totalling $49 billion inflows, with a 16% increase from 2018 according to UN report. Indian business environment is conducive for foreign companies because of favourable policy framework, rules & regulation for entry and exit, stable political & legal environment, healthy competition, favourable trade policies.

There is a favourable regulatory framework in India for FDI. There are several laws regulating FDI inflows in India like Companies Act (1956), Securities and Exchange Board of India Act (SEBI, 1992), Foreign Exchange and Management Act (FEMA), Competition Act (2002), Indian Contract Act (1872), Income Tax Act (1956), etc. There are several government authorities in India concerning FDI like Foreign Investment and Promotion Board (FIPB), Directorate General of Foreign Trade (DGFT), Reserve Bank of India (RBI), Income Tax Department etc.

There are three routes through which FDI flows into India. (i) 100% FDI permitted through Automatic Route (the MNCs do not require the prior approval from the government) (ii) Up to 100% FDI permitted through Government Route (the MNCs require the prior approval from the government) (iii) Up to 100% FDI permitted through Automatic and Government Route subject to rules, regulations, security and conditions. 100% FDI under automatic route is permitted in construction sector in cities and towns, automotive sector, chemical sector, airlines, ports & shipping, medical devices, thermal power, in most of the areas of railways except operations like trains, electrification, mass rapid transport system, etc. The eleven notified sectors/activities requiring government approval are: Mining, Defence/cases relating to FDI in small arms, Broadcasting, Print media, Civil Aviation, Satellites, Telecom, Private Security Agencies, Trading(Single, Multi brand and Food Products), Financial services not regulated or regulated by more than one regulator/ Banking Public and Private (as per FDI Policy) and Pharmaceuticals. There are some sectors where any FDI is completely prohibited: lottery business, gambling and betting, chit funds, Nidhi Company, Housing and Real Estate (except townships, commercial projects, etc.) and manufacturing of cigars, cigarettes and any related tobacco industry.

6.5 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.

6.5.1 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.

6.5.2 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.

6.5.3 Institutions in International Financial System/ International Monetary System

International Monetary Fund (IMF)

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. 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). The IMF continues to serve as a global credit union as well as an organization for research and international economic cooperation.

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.

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. It gives confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with the opportunity to correct maladjustments in their balance of payments, without resorting to measures destructive of national or international prosperity. In accordance with the above, it helps to shorten the duration and lessen the degree of disequilibrium in the international balance of payments of members.

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. The World Bank provides low-interest loans, interest-free credit, and grants to poorer and developing member countries.

The International Finance Corporation (IFC), a sister oragnisation of World Bank & member of World Bank group, provides loans and loan guarantees and equity financing to business undertakings in developing countries. It operates in partnership with private investors. Loan guarantees and insurance to foreign investors against loss caused by non-commercial risks as well as political risk in developing countries and least developed countries are provided by the the Multilateral Investment Guarantee Agency (MIGA)

6.5.4 International Financial Markets

The International Financial Market is the market place where financial wealth is traded among investors and countries. It is a set of rules and institutions where assets are traded between agents in surplus and agents in deficit and where institutions lay down the rules.

The financial market 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.

6.5.5 Balance of Payments

Balance of Payment (BOP) is a systematic accounting record of all the monetary transactions made between residents of a nation and the rest of the nations during a specific period. This statement includes all the transactions made by/to individuals, corporation and the government with the outside world. BOP statement of a country indicates whether the country has a surplus or a deficit of funds, i.e., when a country's export is more than its import, its BOP is said to be in surplus. On the other hand, BOP deficit indicates that a country's imports are more than its exports. BOP is based on standard double-entry accounting system and is subject to all the rules of double entry book keeping, i.e., for every transaction two entries are made, one is credit and another is debit and leaving aside error and omissions, the total of credits must equal to total of debit side. Therefore the BOP must always balance that is debit side will always be equal to credit side in accounting term. The IMF provide Balance of Payment Manual that contains a set of rules to resolve ambiguity related to terms involved such as residents, international etc.

6.6 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 (D) None of these

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.

6.7 Summary

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 INVESTMENT **(**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.

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.

6.8 Keywords

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.

Forward Contract

Forward contract is a contract of buying or selling foreign currency at some fixed date in future at a price agreed upon now.

6.9 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?

6.10 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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Subject: International Business	
Course code: MBA-205	Author: Dr Vijender Pal Saini
Lesson no. : 07	Vetter: Prof. Pardeep Gupta

Foreign Exchange Rates and Management of Exchange Rate

STRUCTURE

7.1 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

7.2 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.

7.3 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.

7.4 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.

7.5 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.

7.6 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.

7.7 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.

7.8 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.

7.9 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.

7.10 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:

7.11 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.

7.12 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

7.13 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.

7.14 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

7.15 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

7.16 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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Subject: International Business	
Course code: MBA-205	Author: Dr Vijender Pal Saini
Lesson no. : 08	Vetter: Prof. Pardeep Gupta

Organizational structure for International Business

STRUCTURE

8.1 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

8.2 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.

8.3 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.

8.4 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

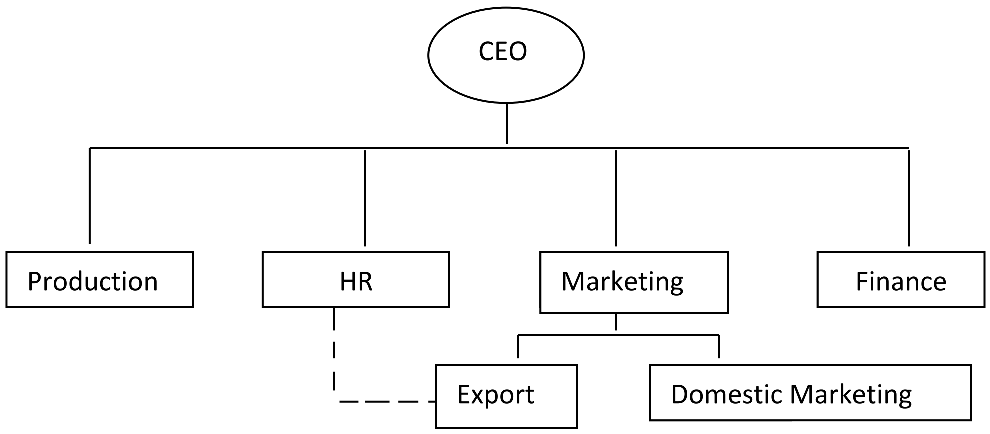
Technology has high impact on the organisational design of the MNCs. Technological aspect which refers to the manner in which various activities will be performed, is an important part of organisational structure. At individual level, the technology is the personal skills and knowledge of the employees. 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.

8.5 International Organizational Structure

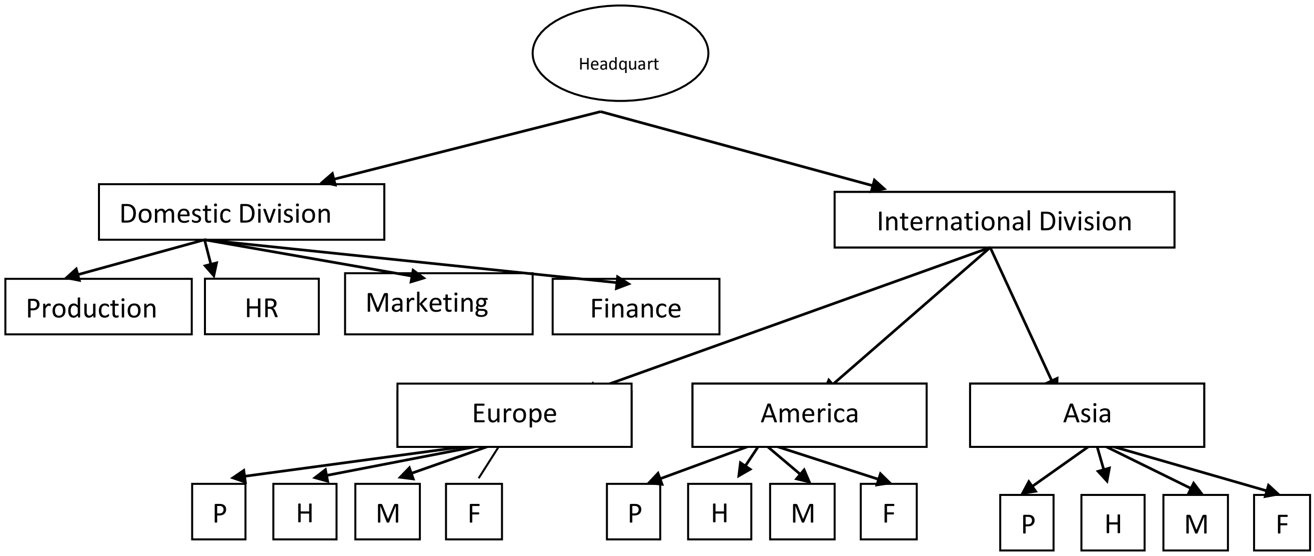
There are various types of international organisational structure like Export Organisational Structure, International Division Structure, International Functional Structure, International Geographical Structure and International Matrix Structure.

8.5.1 Export Organisational Structure



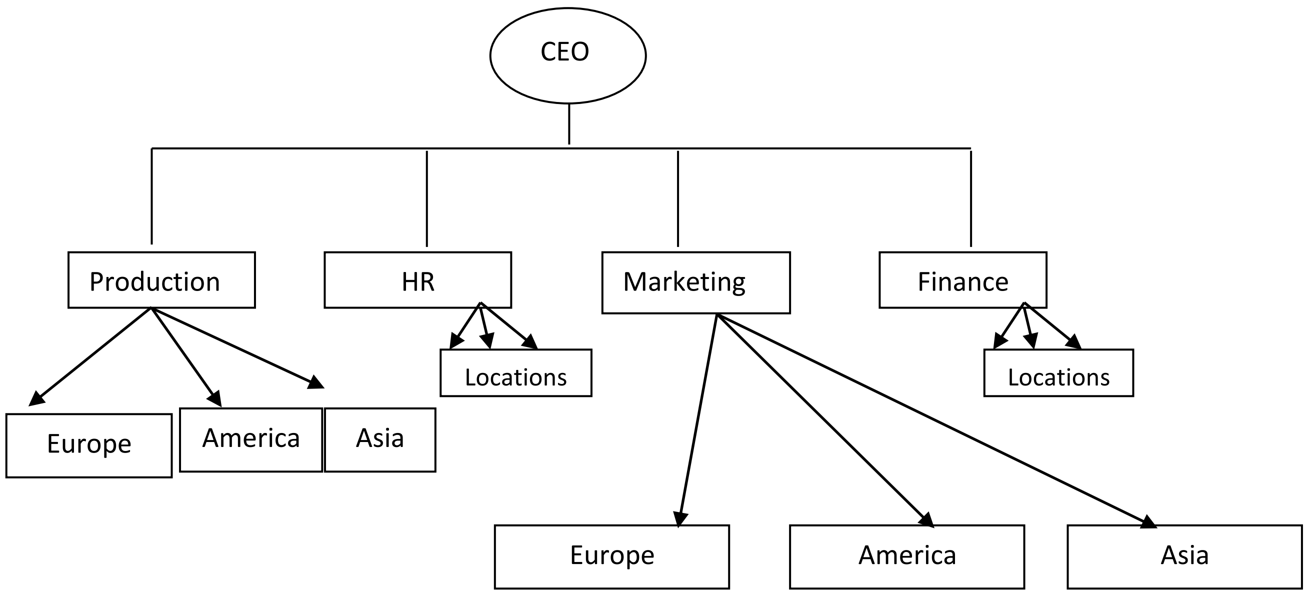
At initial stages, the company's marketing or sales department works and look after the exports in overseas market. CEO is supported by functional managers belonging to production, marketing, purchase, finance, personnel, R&D, etc. But, as the company's export volume and number of importer countries 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.

8.5.2 International Division Structure



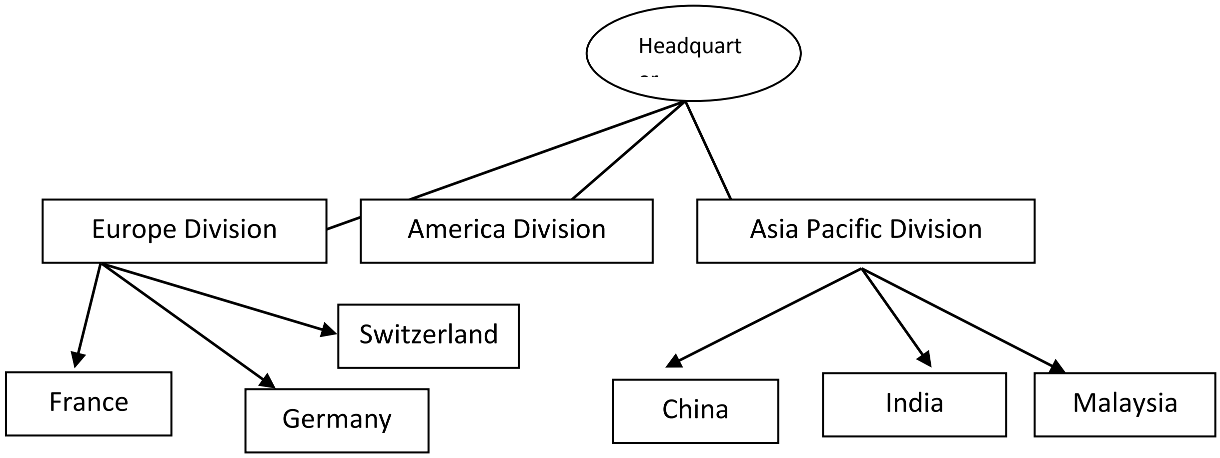
As the company grows and expands its business in overseas market, it establishes international division to cater the growth opportunities abroad. The domestic division is separate from international division usually run by Vice-President. International division have separate subsidiary in different countries, 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.

8.5.3 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.

8.5.4 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.

8.5.5 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.

8.6 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.

8.7 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.

8.9 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.

8.10 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.

8.11 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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Subject: International Business	
Course code: MBA-205	**Author: Dr Vijender Pal Saini**
Lesson no. : 09	**Vetter: Prof. Pardeep Gupta**

International Marketing Management and International Financial Management

STRUCTURE

9.17 Self- Assessment Test

9.18 Answers to Check Your Progress

9.19 References / Suggested Readings

9.1 Learning Objectives

International marketing management is the process of applying marketing strategies and principles in more than one country and international financial management is defined as the management of financial activities in an international business environment. The objective of this chapter is to get the students acquainted with the basic concepts of international marketing management and international financial management.

After reading this chapter, students will be able to:

- Describe the features, advantages of international marketing management
- Explain the features of international financial management
- Understand how to take international financial management decisions
- Importance of international finance
- Understand how to assess international market and generate international strategies.

9.2 Introduction: International Marketing Management

International marketing management is the process of applying marketing strategies and principles in more than one country. It is generally considered as an extension of a company's local marketing strategy in other countries with the objective of satisfying needs and wants of people living across different countries, i.e., designing the marketing mix (Product, Price, Place, and Promotion) worldwide and customizing it according to the preferences of people across different countries. It is also called Global Marketing. According to the American Marketing Association (AMA) "International marketing is the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods, and services to create exchanges that satisfy individual and organizational objectives internationally."

9.3 Features of International Marketing

- Marketing activities are undertaken across the borders to satisfy the needs and wants of customer at global level; generally two or more nations are involved.
- It facilitates the exchange between the company and the customers of foreign countries/host markets and marketing decisions are taken with reference to the global business environment.
- It is a complex process and offers challenges as customised marketing mix is necessary for each of the nations. For example: McDonald, having its restaurants in more than 110 countries modifies its traditional big mac in India, where it is named as the Maharaja Mac. The burger is available in two mutton patties because cow is considered sacred in India and Indians don’t eat beef.
- It offers attractive opportunities for the business firms along with severe challenges and threats.
- All the strategies and principles of modern marketing are also applicable to international marketing and it can be considered as marketing at a very broad level.

9.4 Advantages of International Marketing

Increased Revenues

Doing international trade always provide opportunity of earning extra revenues. Thus MNCs running in various countries are having large number of customer base, providing opportunity for earning more revenue and large market for their product or service.

Longer Product Lifespan

Sales can go down for certain products domestically but it may not in other countries. Companies with international operations can offset negative growth in one market by operating successfully in another market. Thus, it also reduces risk. Companies also can utilize international markets to introduce unique products and services by continuously making innovations and indulging in research and development activities, which can help maintain a positive revenue stream.

Better Risk Management

Risk can be managed by diversifying the whole market. Focusing only on the domestic market or only in one country market may lead to increased risk, i.e., slowdown of the economy, political instability factors, environmental events and other risk factors. Becoming less dependent on a single market and diversifying in other markets with diversified products helps the MNCs to mitigate potential risks in their corresponding core market.

Benefiting from Currency Exchange

MNCs too get benefitted from exchange rate variations. For example, when the currency of one country, say, U.S. dollar is down, then MNCs can prefer to export more as foreign customers benefit from the favourable currency exchange rate.

Access to Export Financing and Government Assistance

MNCs get leverage export financing. The EXIM bank of India provides assistance to exporting firms by providing concessional loans and helping to face liquidity crunch.

Rapid Industrial Growth

MNCs help to prosper the industrial growth of economies (host country as well as home country), i.e., demand for new goods is created through international market which in turn leads to new job opportunities, complete utilization of natural resources, etc.

Comparative advantage

International marketing ensures comparative cost benefits to all the participating companies. The MNCs avail the benefits of cheap labour & specialization at the international level through international marketing.

Access to Cheap and Skilled Labour

Many MNCs employs cheap, talented and skilled labour available in African and Asian countries. For example, when Netflix expanded its business into Amsterdam, the company hired multilingual and internationally minded employees from there, those employees can expertly "understand consumers and cultures in all of the territories across Europe." Moreover, MNCs welcome the global entrepreneurs and skilled workers from all over the world.

Brand Image of the Company

International business can also increase a company's perceived brand image. Operating at global level can help the MNCs to build name brand recognition which could support future business scenarios, such as contract negotiations, new marketing campaigns or even additional expansion.

Need and Importance

According to Philip Kotler, “Two forces are very essential for the international marketing: pull forces and push forces. Push forces lead the nation to sell its goods and services in other nations”. This strategy may be adopted by traders of a country due to following factors: low per capita income, low domestic demand, unfavourable work environment, high rates of tax and duties, government incentives to promote export to earn foreign exchange, tough competition in local market, etc. Another set of forces is pull forces. The pull forces pull businessman to sell their products in the foreign market to exploits attractive opportunities in the foreign countries. To take benefits of more profitable opportunities, they are pulled to business in other nations. The variables lead to international market may fall either in pull forces or push forces or both.

9.5 Difference between Domestic and International Marketing

Domestic marketing is said when commercialization of goods and services and application of marketing strategies are limited to the home country only. On the other hand, **international marketing is the process of conducting marketing activities** across several countries/host markets in the world.

Major Activities in International Market

International marketing activities are interwoven with the other key decisions of firm, i.e., firm’s corporate goals, objectives and strategy. The objectives and strategy of a firm largely affects the international marketing decisions such as whether to enter new markets and how much risk the company is ready to taken, whether to decentralise or centralise the decisions of firm.

9.6 International Market Assessment

Selection Criteria

In selecting the best foreign markets to be entered, Hammond, Russell and many other trade experts have identified some key criteria that need to be considered. "At first, the factors you choose to consider may seem fine, but once you have travelled to a particular country and learned a lot more about the market; the perspective can change considerably."

- **Market Demand**

It is very important to identify countries having demand (in quantity and value) for the company’s product or service. This data helps in calculating the total market size, its rate of growth, the percentage of market share, whether or not it is increasing or decreasing, and the level of competition and receptivity toward the product. As for example, Hindustan Unilever introduced different soap in India like Lux, Lifebuoy, Dove, Rexona, Pears, Lyril. In the case of soap pricing, the palm oil prices and the rural & discretionary spending are important factors in India. Hindustan Unilever's marketing of soap is successful in India because the soaps are targeted to different segments in the market. Unilever selected celebrities from local market, repackaged and reformulated its soaps according to Indian market. The strategy was successful because the company targeted different segments of the market.

- **Level of Competition**

Learn as much as about the competition and the available substitutes of the company's products including their product price, quality, marketing strategies, distribution methods, consumer loyalty and their ability to provide after-sales service. If the number of competitors is large, it may be more advantageous to target a smaller, niche market, with less intense competition.

- **Country Performance**

Perform an assessment of the macro-economic indicators and trends of each selected country. Population, per capita income, consumer demographics, ease of doing business, market size, social & cultural environment, political & legal environment, etc., are important indicators. If the demand for the company's product is increasing in a particular host market, but if the country's overall economic performance is decreasing, it may affect the product demand negatively. However, if the product demand has risen as well as country's economic performance is also improving, then the country may offer opportunity for long-term profitability. It is also important to keep knowledge of the selected country's level of political stability, especially in case of developing countries.

- **Trade Barriers**

It's very important to identify all the tariff and non-tariff barriers, standards, regulations, quotas, import licenses, necessary adaptations, packaging and labelling regulations, etc., of each host market selected. It is also important to be familiar with the changing regulations, legal formalities and penalties to be imposed for non-conformance of the regulations.

- **Climate and Location**

The climatic and geographical conditions of selected countries should also be considered. The location of the firm's storage house and various facilities should also be kept in mind. The shipping costs of heavy/hazardous materials to distant locations may eliminate profit margins, even increase the overall cost.

- Infrastructure

The availability of physical infrastructure, such as roads, utilities and telecommunications facilities should also be considered. Environmental standards regarding products differ from country to country. Some developing countries may not have adequate facilities to store toxic by-products generated by the manufacturing process that may lead to serious health risk and legal problems.

- **Intellectual Property Protection**

The enforcement of patent and trademark laws should be considered. Strong and soundly enforced patent and trademark laws better protect the MNCs from stealing their technology.

9.7 International Marketing Strategy

Due to increasing globalisation, even smaller companies have become able to cross national boundaries and do business abroad. Consequently MNCs are being given many terms, i.e., multinationals, global companies, transnational companies, international firms, etc. Bartlett & Ghoshal Matrix (1989) gave the framework that distinguishes between the different forms of internationally operating firms. Bartlett and Ghoshal grouped these businesses based on two criteria: (i) Global Integration and (ii) Local Responsiveness.

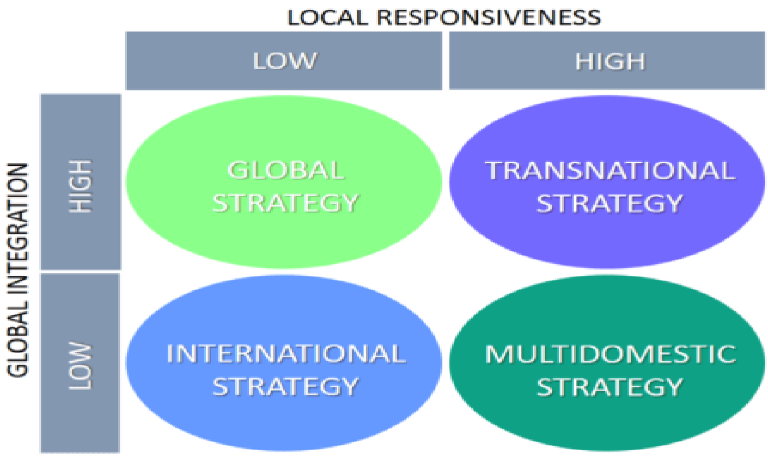
(i) Global Integration/Standardisation

Business firms that are having the objective to reduce costs by creating economies of scale through a more standardized product adopt global integration approach and offer standardised products to whole market.

(ii) Local Responsiveness/Customisation/Adaptation

Considering the diversity of global markets, understanding each region is very important to successfully run the business at the global level. Many a time companies consider other markets as extension of the home markets and hence fails. The organisation must adapt to the needs and wants of local customers and must adapt their marketing strategies and offerings according to their requirements and environment. Even digital marketing has to be adapted to different countries and regions because the 'one size fits all' will not work for online campaigns too. A business firm that does not respect local cultures, sentiments, tradition and the consumer as an individual is bound to fail. Business firms those are locally responsive and more adaptive to local needs and wants get the benefit of customisation or adaptation.

Together these two criteria generate four types of strategies: Multidomestic, Global, Transnational and International strategies.



Multidomestic: Low Integration and High Responsiveness

In case of Multidomestic strategy, the local responsiveness is high and global integration is low. The firm concentrates on fulfilling the domestic customer's needs and wants, and no more attention is paid to customers outside the domestic countries.

International: Low Integration and Low Responsiveness

An international company has very less amount of local adaption and global integration. The majority of the decisions related to business are taken at headquarter. This strategy is therefore called as exporting strategy i.e. products are produced in the home country and are exported to customers all over the world.

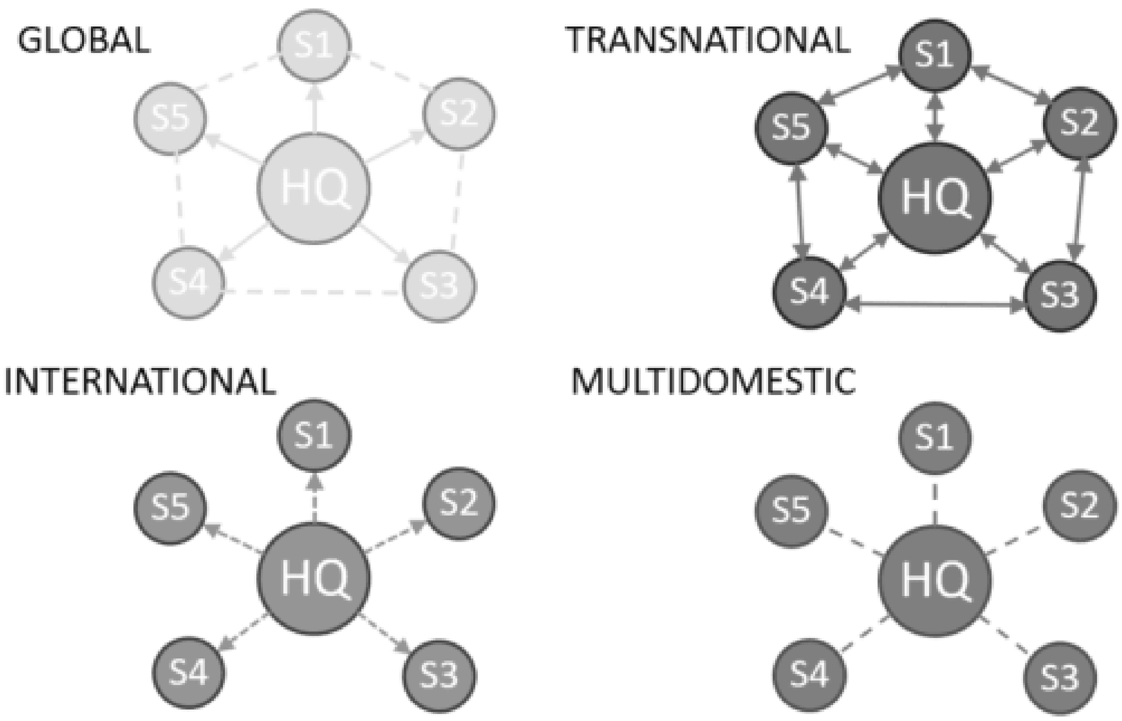
Global: High integration and Low responsiveness

A global company is a company having operations in many countries and more or less having independent operations across the world, but sell products or service which are standardised. These are dependent on headquarter and have central decision-making. This model is also known as the hub-and-spoke model.

Transnational: High Integration and High Responsiveness

A transnational company is a company in which independent units work across the world and the whole world is considered as a market. Consumer tastes, preferences, choices and interests differ from country to country, climatic zones, GDP levels (Gross Domestic Product), customs and traditions. However its objective is to maximize local responsiveness but it also get benefitted from global integration. Transnational companies are more flexible and create economies of scale upstream in the value chain and are locally responsive in downstream activities such as marketing and sales. A transnational company consists of an integrated and interdependent network of subsidiaries all over the world. All the subsidiaries have their own objectives and individually they act as centres of excellence.

It can be concluded that to be successful in business in international level; the firms must adapt the local needs and wants and customise their marketing campaign.



As for example, Domino's has focused its approach towards prioritizing its menu innovation to use its menu as a mean of creating interest and awareness among consumers at a global level. Coca-Cola is a great example of successful MNCs. Despite being a large corporation, Coca-Cola focuses on small communities and invests a lot of time and money in small-scale charity programs. For example, in Egypt, Coca-Cola has built 650 clean water installations in the rural village of Egypt. In India, Coca-cola sponsored the 'Support My School' initiative to improve facilities at schools. The brand is adopting a strategy of selling an emotion: happiness. Nestle is a company with a Multidomestic strategy. It is having as its objective to meet the needs and requirements of the local markets worldwide by providing customized products and services. It uses a unique marketing and sales approach for every market in which it operates. Pfizer is a pharmaceutical company having presence in the world market as a global company. Global companies are having feature which are opposite of Multidomestic companies. Pfizer offers a standardized product worldwide and having its objective to maximize efficiencies by reducing costs. Unilever is a transnational company having features of both the global and multidomestic firm. It is having its subsidiaries all around the world and its entire subsidiaries works as independent units. All subsidiaries are having their own mission and objectives statements, products and marketing strategies etc. All the units are evaluated individually.

9.8 International Product Strategies

An international product strategy refers to making all the decisions related to the firm's product and services to be offered in the international market. It consists of decision related to products (or product lines) to be offered in each country market, standardisation or customisation and new product development. It is often regarded as the core of the international marketing mix strategy as the product and its core benefits must ultimately fulfil the customers' needs and desires; the other elements of the marketing mix usually cannot compensate for deficiencies in the product. The product strategy is considered as the starting point for further marketing mix decisions.

9.9 International Financial Management

International financial management is defined as the management of financial activities in an international business environment. It is also known as international finance.

The concept of international financial management came into existence when the countries in the world started trading with each other, i.e., liberalise the economies. Due to the opening of economies and liberal environment and freedom to move anywhere to do business in any region of the world, entrepreneurs started looking for opportunities in and outside of geographical boundaries of their countries. Further innovations in the area of telecommunications and transportation technologies enhanced the accessibility across the world. Apart from these, the innovations in area of finance such as currency swaps and derivatives, cross-border stock listings, multi-currency bonds and international mutual funds, etc., have collected the world closer.

Financial management in case of a domestic business and an international business is dramatically different due to differences in the opportunities in the two. Although the meaning and objective of financial management do not change in international financial management but the dimensions and dynamics change drastically.

9.10 Importance of International Finance

International finance plays an important role in international trade. It works as an important tool to find the exchange rates, compare inflation rates prevailing among countries, to ascertain the economic scenario of other countries and to evaluate the foreign markets.

- International finance helps in calculating exchange rates. Exchange rates let the investor and various stakeholders to determine the relative values of different currencies.
- It helps in evaluating various economic factors through which the investor decide whether to invest or not in particular countries. Also in determining whether or not investors' money is safe in foreign debt securities.
- The utilisation of International Financial Reporting Standards (IFRS) for preparing financial statements brings uniformity and comparability which helps many countries to follow similar reporting systems. IFRS system also helps in saving money by following the single accounting standards.
- An international finance system helps in maintaining peace among the nations. Without a solid financial management system, all nations would work for their self-interest hence international finance helps in keeping countries organised.

- International finance institutions, i.e., IMF, World Bank, UNCTAD, etc., coordinate and monitor the functioning of various countries.

9.11 Features of International Financial Management

International Finance is a distinct field of study having certain features which are as follows:

- **Foreign Exchange Risk**

International financial management is equipped with the risk of foreign exchange. Foreign exchange risk works as a very large hurdle that a finance manager must cope up with in an international environment. An understanding of foreign exchange risk is essential for managers and investors because due to fluctuations in foreign exchange rates they are to suffer from huge losses or can be benefitted. In a domestic business generally this kind of risk is considered as nil because the domestic country's currency serves as the medium of exchange. Whenever the exchange is made in different national currencies, there is always the risk of volatility/unforeseen changes in foreign exchange rates. Foreign exchange risk refers to the risk associated with fluctuations in the prices of currency that carry the potential to convert a profitable deal into a loss-making one. The establishment of IMF is characterised by the International Monetary System according to which there is the mix of floating and managed exchange rate policies adopted by each nation keeping in view its interests.

However, this variability of exchange rates is largely considered as the most serious international financial problem today facing corporate managers, investors and policy makers. Sometimes, the exchange rates of major economies too fluctuate in unpredictable manner, i.e., the US dollar, British Pound, Japanese Yen and the Euro. The variation in exchange rate affects the profitability of firms and preparation of financial statements. Therefore, it is must for all the firms to understand foreign exchange risks to anticipate increased competition from imports and to value increased opportunities for exports.

- **Political Risk**

International companies generally face political risk in international markets. Political risk may involve the risk of loss or gain from unforeseen government actions, policies due to political instability or any other events of a political character such as acts of terrorism, or decisions related to outright the expropriation of assets held by foreigners. MNCs must assess the political risk in all the countries where they are operating and also in countries where it expects to establish subsidiaries.

The extreme form of political risk is when the foreign country government changes the ‘rules of the game’ and the affected parties have left with no other alternatives. The companies face problems in enforcing contracts in host countries. Thus, political risk largely affects the international operations than those in case of domestic operations and is generally found to be more complex.

- **Expanded Opportunity and Economies of Scale**

By taking the business across national boundaries, a firm can enhance its chances of reaping fruits of a different taste. Not only does it enhances the opportunity for more business but also diversifies the overall risk of business to various nations.

It is true that firms are faced with a lot of difficulties and risk while going global but they also get benefitted from expanded opportunities. They can raise funds in international capital markets where cost of capital is the lowest. In addition, firms can also gain from larger economies of scale due to operating globally.

- **Market Imperfections**

One of the main features that distinguish the international financial management form domestic financial management is imperfection of global markets. There exist differences among nations’ laws, taxation systems, transportation and information processing cost, business customs and practices and general social and cultural environments. Imperfections in the world financial markets tend to restrict the extent to which investors can diversify their portfolio. Although there are risks and costs associated with imperfect markets, they also offer abundant opportunities of earning profits.

9.12 International Financial Market

The International Financial Market is the market place where financial wealth is traded among investors and countries. It is a set of rules and institutions where assets are traded between agents in surplus and agents in deficit and where institutions lay down the rules.

The financial market 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.

Since few years, Eurocurrency and Euro-bond markets are gaining popularity as a means of medium and long-term financing for international investors and corporate.

9.13 International Financial Management Decisions

(i) To Decide Capital Structure

One of the main objectives of the international financial management is to determine the ideal long-term mix of various instruments for financing the firm's international operations and projects. It involves decisions related to (a) Equity Financing (b) Debt Financing.

(a) Equity Financing

It is the process to issue equity shares to raise capital from investors at different countries and using the retained earnings to reinvest in the firm.

(b) Debt Financing

It is the process to borrow money from banks, corporate using debt instruments or from other financial intermediaries, or selling of corporate bonds to individuals or institutions, to raise capital.

The general practice opted by most of the MNCs is to keep the debt proportion of their capital structure low, generally, below a threshold that they can meet even in adverse conditions. It helps them to minimize the risk associated with the bankruptcy and to maintain a good credit rating. To maintain debt-equity ratio healthy is a very important decision of the companies in host countries.

(ii) Raise Funds for the Firm

It is obtaining funds for value-adding activities and investment projects. Financing may be made from three sources (a) Intra-corporate financing: Funds from sources inside the firm (both headquarters and subsidiaries) such as equity, loans, and trade credits. (b) Debt / Equity (c) International Loans / Bonds. Bonds are the debt instruments which are used popularly by international companies doing business across national boundaries. Bond is a debt instrument that enables the issuer or borrower to raise capital by promising to repay the principal along with interest on a specified date/ maturity.

(iii) Foreign Exchange Market

Economic and commercial relations among countries involve exchange of goods and services and payments for these exchanges. The payments need to be converted from one currency into another.

The foreign exchange market is the market where currencies are bought and sold against each other. It is an over-the-counter market. Foreign Exchange market is the largest market in the world in terms of volume trading. The forex market is actually a worldwide network of inter-bank traders, consisting primarily of banks and corporate conducting trade via telephonically and computer. The forex market functions virtually 24 hours that enables the trader to offset the position created in one market by taking position in another market. The majority of inter-bank foreign currency transactions are handled in London, Tokyo, New York, Zurich and Frankfurt and rest of bulk happen in Hong Kong, Singapore, Paris, and Sydney etc.

Each country owes its own financial system and its own currency and financial assets. Exchanges between the money and financial assets of one country for money or financial assets of another country constitute international financial transactions. The financial assets may include money or near-money assets, cheques, drafts and other negotiable instruments. The demand for any currency as against its supply in such markets determines the exchange rate.

(iv) International Currency Markets

Along with foreign exchange market, there are international currency markets where internationally accepted currencies are traded. Reserve currencies are related to the deposits of currencies with international banks at an agreed rate of interest. The excess funds in these reserve currencies owned by countries, institutions and governments having surplus receipts over payments would be lent out to banks and other financial institutions for various durations at a rate of interest. The currencies are in demand for meeting the balance of payments deficits or for investment in fixed capital or for working capital purposes.

(v) Balance of Payment (BOP)

Balance of Payment (BOP) is a systematic accounting record of all the monetary transactions made between residents of a nation and the rest of the nations during a specific period. This statement includes all the transactions made by/to individuals, corporation and the government with the outside world.

BOP is based on standard double-entry accounting system and is subject to all the rules of double entry book keeping, i.e., for every transaction two entries are made, one is credit and another is debit and leaving aside error and omissions, the total of credits must equal to total of debit side. Therefore the BOP must always balance that is debit side will always be equal to credit side in accounting term. BOP statement of a country indicates whether the country has a surplus or a deficit of funds, i.e., when a country's export is more than its import, its BOP is said to be in surplus. On the other hand, BOP deficit indicates that a country's imports are more than its exports.

The IMF provide Balance of Payment Manual that contains a set of rules to resolve ambiguity related to terms involved such as residents, international etc.

9.14 Check Your Progress

1. Choose the right match:

   (A) Multidomestic: Low Integration and Low Responsiveness

   (B) International: High Integration and High Responsiveness

   (C) Global: High integration and Low responsiveness

   (D) Transnational: Low Integration and High Responsiveness

2. Which one is not the feature of international marketing?

   (A) Marketing activities are undertaken across the borders to satisfy the needs and wants of customer at global level; generally two or more nations are involved.

   (B) It facilitates the exchange between the company and the customers of foreign countries/host markets and marketing decisions are taken with reference to the global business environment.

   (C) It offers attractive opportunities for the business firms along with fewer challenges and threats.

   (D) All the strategies and principles of modern marketing are also applicable to international marketing and it can be considered as marketing at a very broad level.

3. Advantages of international marketing include:

   (A) Increased Revenues

   (B) Longer Product Lifespan

(C) Better Risk Management

(D) All the above

4. Which is not a feature of international financial management?

(A) Exchange Risk

(B) Interest rate risk

(C) Political risk

(D) Market Imperfections

5. Which is not a consideration in context of international finance?

(A) IMP

(B) WTO

(C) Foreign Exchange

(D) WHO

9.15 Summary

International marketing management is the process of applying marketing strategies and principles in more than one country. Marketing activities are undertaken across the borders to satisfy the needs and wants of customer at global level; generally two or more nations are involved. It facilitates the exchange between the company and the customers of foreign countries/host markets and marketing decisions are taken with reference to the global business environment. All the strategies and principles of modern marketing are also applicable to international marketing and it can be considered as marketing at a very broad level.

Advantages of international marketing are Increased Revenues, Longer Product Lifespan, Better Risk Management, Benefiting from Currency Exchange, Access to Export Financing and Government Assistance, Comparative advantage**, Access to Cheap and Skilled Labour** Brand Image of the Company and Rapid Industrial Growth.

Factors of international market assessment are, Market Demand, Level of Competition, Country Performance, Trade Barriers, Climate and Location, **Infrastructure,** Intellectual Property Protection.

International Marketing Strategy is based on the criteria (i) Global Integration and (ii) Local Responsiveness. Together these two criteria generate four types of strategies: Multidomestic, Global, Transnational and International strategies.

An international product strategy refers to making all the decisions related to the firm's product and services to be offered in the international market.

International financial management is defined as the management of financial activities in an international business environment. It is also known as international finance.

International finance plays an important role in international trade. It works as an important tool to find the exchange rates, compare inflation rates prevailing among countries, to ascertain the economic scenario of other countries and to evaluate the foreign markets.

International Finance is a distinct field of study having certain features which are as follows: Foreign Exchange Risk, Political Risk, Expanded Opportunity and Economies of Scale and Market Imperfections

The International Financial Market is the market place where financial wealth is traded among investors and countries. The financial market 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.

International Financial Management Decisions are to decide Capital Structure, Equity Financing, Debt Financing, Raise Funds for the Firm, Foreign Exchange Market, International Currency Markets, and Balance of Payment (BOP).

9.16 Keywords

Balance of Payment (BOP)

Balance of Payment is a systematic accounting record of all the monetary transactions made between residents of a nation and the rest of the nations during a specific period.

Standardization

Standardization means one size fits all. Standardized marketing mix attempts to accomplish uniformity across the whole business process. Standardized goods are mass produced with uniform in quality.

Customization

Customization or adoption of marketing mix refers to tailoring the products and services according to the needs of individuals or groups of individuals. Customized goods are produced with a market focus and varied according to the needs of the customers.

9.17 Self- Assessment Test

1. What do you mean by international marketing? Explain the features and advantages of international marketing.

2. What are the key decision areas of international marketing? Explain in detail.

3. Define international financial management. What are the advantages and disadvantages of international financial management?

4. Explain the major decisions of international financial management.

5. Elaborate international Marketing with an example of multinational company.

9.18 Answers to Check Your Progress

(1) C (2) C

(3) D (4) B

(5) D

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Course code: MBA-205	Author: Dr Vijender Pal Saini
Lesson no. : 10	Vetter: Prof. Pardeep Gupta

International Production Management and International HRM

STRUCTURE

10.1 Learning Objectives

International production management deals with production of goods and services in international locations and markets. International human resource management can be defined as the set of activities involved with employees ensure the success of strategy of the company. The objective of this chapter is to get the students acquainted with the basic concepts of international production management and international human resource management.

After reading this chapter, students will be able to:

- Explain the nature, importance of international human resource management
- Describe the need, nature and importance of international production management
- Understand international production strategies
- Understand **international human resource activities**

10.2 Introduction: Meaning of International Production Management

International production management deals with production of goods and services in international locations and markets. It involves management process which has to take into consideration of labour and capital and international customer requirements. International production management is a process of adopting and applying management principles to the production activities in a factory to efficiently and effectively utilise the resources and achieving the strategic goal of organisation of minimising cost in the overseas market. In other words, international production management involves application of process of management, i.e., planning, organizing, directing and controlling the production process by the subsidiaries in host countries.

> THE PRODUCTION FUNCTION IS THE MOST IMPORTANT FUNCTION IN ANY ORGANIZATION. IT IS THE CENTRAL POINT OF THE ORGANISATION AROUND WHICH OTHER ACTIVITIES OF AN ENTERPRISE SUCH AS MARKETING, FINANCING, PURCHASING, AND PERSONNEL REVOLVE.

It is also known as operation management and industrial production process management. It is **operations management**, **planning, and control of industrial processes** to ensure that the production activities in the factory move smoothly in the desired way in the foreign markets by subsidiaries. "**Production** Management is the process of making decisions related to the production process to ensure that the resulting goods and services are produced as per the quantitative specifications and at pre-determined demand and time schedule with **minimum cost".**

According to Elwood Spencer Buffa, "Production management deals with decision-making related to production processes so that the resulting goods or service is produced according to specification, in the amount and by the schedule demanded and at minimum cost."

Production management has its origin from development of factory system of production. This concept came into existence when Taylor introduced the principles of scientific management.

10.3 Characteristics of International Production Management

- Production Management is the process of effective planning. It helps in regulating the most important operations of an enterprise that is the actual transformation of raw materials into finished products.

- It is related to the production process. Production management is concerned with the process of production of goods and services and required to ensure that products are produced in as per the quantitative specifications and demand and time schedule with minimum cost.
- **Production Management is a set of general principles for production.** Production management contains a set of certain principles which are followed to effectively manage the process of production like production economies, facility design, store location, job design, schedule design, quality control, inventory control, work and motion-study, cost, and budgetary control.

10.4 Objectives of International Production Management

- The main objective of the international production management is to meet international quality and environment standards.
- To produce the desired product or specified product by specified methods to optimally utilises the available resources in the global markets.
- To produce goods at minimum cost by proper planning of the manpower, material and processes available in overseas markets.
- To deliver right products in right quantity at right place and at right price to the customers in host countries.
- To forecast demand and production design for customers in different countries.
- To increase profitability and profit sharing.
- Adaptation to modern available technology and further innovation to be competitive in the international market.

10.5 Difference between Domestic Production Management and International Production Management

The foundation for international production and operations is similar to domestic production and operations management as in both cases there is requirement of man, material, and machine. But there are certain aspects which makes international production and operation management more challenging for an organization because

- International business environment consists of many factors and is too complex. The requirement and maintenance of international quality standards are very high and has to be maintained as per the norms of the host country. Domestic production management provides goods and services to single local market therefore not much variation in quality standards where as in international production management has to consider different international markets with different quality standard requirements.

- It is easy to find out best locations, regulations and easy to start production in domestic market. While understanding of different country's cultures, location and regulations makes international production and operation management more complex.

- Domestic production faces local market, hence limiting scope of economies of scale whereas in international production larger economies of scale are required to be competitive in the overseas market.

- International production has to deal with developed and diversified market which is to be segmented on the hybrid basis.

- There is homogenous environment in domestic country while there is heterogeneous environment in international host markets that deals with the concept of multi-culture, multi-ethnicity and multi-lingual scenario.

- Domestic production management has to consider local economic and social factors where as international production management has to deal with different economic and social factors in different countries.

- In domestic market competition would be less and the prices of product are affected only by production cost whereas in case of international market the organisation has to consider the competitors' pricing strategies, customers' purchasing power across countries, foreign exchange fluctuations and other factors also.

- In domestic environment innovation and usage of technology may provide competitive edge very easily due to less number of competitors. In international markets, the number of competitors is very high.

- In international production, there is an advantage of moving around of resources from high cost market to low cost market.

10.6 International Production Strategies

International organizations need to consider the following point while developing strategies in host markets:

- **Production/Factory Location**

The production or factory location is strategically very important for international oragnisations because it requires huge & permanent investment for long period. The MNCs should consider the choice of location for the production facility depending on its proximity near to the market, availability of raw material, labor and cost of production in that particular environment.

- **Factory Design, Layout and Quality Standards**

International organizations need to standardize design and layout across their production location as to minimize production cost. MNCs require maintaining standards in the host countries to be competitive.

- **External Vendor and Procurement**

International organizations need to finalize among the vendors available in the host markets to get raw material as well important components to complete the final product within the specified time. Also procurement schedule has to be finalized as not to hurt production. Procurement is made across countries, which need to manage very carefully.

10.7 Introduction: International Human Resource Management (IHRM)

Globalisation in the world has led the movement of human resources all over the world. Now-a-day's people belonging to one nation are working in another nation. Innovations in the modes of transportation as well as internet have contributed into a great extent in this area. Further, the increasing involvement of women in working sector has changes the working circumstances tremendously. These entire consequences make international human resource management very important. International human resource management is the management of human resources working at countries other than their own country. The set of activities in international human resources are recruitment, selection, performance appraisal, compensation, training and development, industrial relations, career management, etc. in the different host countries. Strategically, international HRM is closely related to the business strategy of the organization.

In today's environment, companies are having subsidiaries in many countries almost in every field like hotels, software development institutions, banking, BPO companies, educational institutions, logistics & transportation, mills, automobile industry, etc. The main objective of the international oragnisation is to implement the business strategies cautiously and to achieve the target with the given or allocated investments. Hence, the important of human resource management in a global perspective increases manifold.

10.8 Definition of International Human Resource Management

International human resource management (IHRM) is the process of managing people worldwide. International human resource management can be defined as the set of activities involved in hiring, managing performance, providing compensation, training and development and managing relations with the employees hired to manage operations of a company in the international markets to ensure the success of strategy of the company. International human resource management deals with at least three types of employees based on their country of origin (i) Parent-Country Nationals (PCNs) – Employees belonging to the parent country where the company's headquarter is located. (ii) Host-Country Nationals (HCNs) – Employees belonging to country where the company is having subsidiary or a manufacturing facility are called host- country nationals. (iii) Third-Country Nationals (TCNs) – Employees who work in the home country or host country facility of the company but are not nationals of either (not of home as well as host country) are called third- country nationals.

According to Pulapa Subba Rao, the definition IHRM is as follows: "International human resource management (IHRM) is the process of procuring, allocating, and effectively utilizing human resources in a multinational corporation. If the MNC is simply exporting its products, with only a few small offices in foreign locations, then the task of the international HR manager is relatively simple."

10.9 Need of International Human Resource Management

International human resource management (IHRM) is the process of managing people in the host countries. IHRM is required because it helps in:

- To develop managerial skills, organisational knowledge and technical abilities of employees in the parent company as well as in subsidiaries located around the globe. It helps in getting competitive edge by developing strength in human resource.
- To develop manpower to better handle of global business operations efficiently & effectively, i.e., to get efficiency in global operations through human resource.
- To manage and secure the performance, compensation and career path of employees globally.
- To help the employees to be flexible and adaptable to the changes occurring in global business environment.
- To manage and organise cross-cultural counselling and language-training programme between parent company and subsidiaries as well as among subsidiaries.
- To make employees capable of transferring learning and technology across all their globally dispersed units.
- It helps the employees to understand the culture in the host countries and make them locally responsive towards needs and wants of customers.
- To develop more feasible understanding of work practices at global levels.
- To raise and develop better and new performance management of human resources so as to convert the organisations into world class organisations.
- To get more and more opportunities within global HR scenario.
- To develop better and competitive HR strategies in global competitive scenario.

10.10 Nature of International Human Resource Management

➢ **Flexibility**

International HR manager must adopt flexible practices. Flexibility is a key to success for every organisation. However in case of IHRM the requirement of flexibility is more as every country is different in its nature and environment and the strategies that headquarter has designed may not work perfectly in every country. Therefore flexibility is required while conducting global standards and processes.

➢ **Uncertain Environment**

International HR often face with uncertainty in various situations. For example, the unpredictable decision of governments often provides threats for MNCs. Therefore, IHR manager need to analyze the situation and provide suitable solution for that.

➢ **Cultural Awareness and Sensitivity**

Each nation of the world is different. Each having unique culture, different languages are spoken there and having different regulatory working ethics and norms. For example, to wear white dresses on auspicious occasion is considered good in European countries, whereas it is not good to wear white on such occasion in Asian countries.

➢ **Performance Management**

Performance management is another very important area. Performance appraisal in case of domestic firms is not same as for international firms. International HR manager are required to appraise the person working in the various subsidiaries in various countries according to their diverse nature and culture.

➢ **Adaptability to Local Laws**

The adaptability towards the labour laws and industrial relations are required while working in other countries. The laws and things are different from domestic country. For example, the rules regarding labour unions in Europe and Latin America are very different from the US.

➢ **Respect the Diversity**

It is a common phenomenon to find out diversity among the people in their living style, eating habits, social and cultural behaviour. The company can leverage the diversity by respecting the diversity among the workforce.

10.11 Importance of IHRM

HRM is of great importance at present for a number of reasons**:**

- Recent years have witnessed the rapid growth of globalization and international competition. The increasing number of multinational corporations (MNCs) has contributed towards the growing importance of the international role of human resource management.
- The effectiveness and quality of human resource management is one of the major factors to determine the success or failure of the international business and is very critical in case of international business.
- Managers with international exposure and experience are not born but they are created by training and development which affects corporate efforts to expand abroad. Today market requires managers with distinctive competence and context-specific knowledge of how to do business successfully in countries which are both culturally and economically different from head office. Thus, a very important responsibility lies in IHRM.
- The failure in the international business often harms corporation not just in monetary terms but in human terms also. Therefore, companies are required to take precautionary actions to train and compensate human resources.
- Culture is defined as shared values. It is one of the key factors which affect people-oriented processes of a country. HRM is a people-oriented and dynamic process. Therefore, culture largely and significantly affect on HRM practices.
- Workforce diversity is commonly found in today's large organizations even in domestic ones. A global firm may hire its employees from three types of countries — home country (PCNs), host country (HCNs), and third country (TCNs). Therefore, company can leverage the diversity among the workforce. Therefore the firm must respect the diversity of workforce.

10.12 International Human Resource Management Approaches

International business approaches can be divided into following forms as suggested by Perlmutter:

- **Ethnocentric**

In ethnocentric approach, all strategic decisions related to subsidiaries and their human resources are made at headquarters. All the key positions at the domestic and foreign subsidiaries are held by headquarters' management personnel, i.e., expatriates (Home/Parent country personnel).

- **Polycentric**

The MNE treats each subsidiary as a distinct entity and are provided with decision making autonomy related to respective subsidiaries. Subsidiaries are managed by local country nationals (Host Country Nationals) who are usually not promoted to top positions at headquarters.

- **Geocentric**

In this approach, the MNE adopts a worldwide approach to its subsidiaries. The worldwide integrated approach is adopted and ability and competency is preferred over nationality. For example, PCNs, HCNs, and TCNs can be appointed in key positions anywhere, including those at the senior management level at headquarters and on the board of directors.

- **Regiocentric**

This approach reflects the geographic strategy and structure of the multinational enterprises. The employment from a wider pool of managers is made but in a limited way. Personnel may be employed outside their home countries but only within the particular geographic region. Regional managers are usually not promoted to headquarter positions. However they enjoy regional autonomy in decision-making.

10.13 Activities and Cultural Dimensions of International Human Resource Management

Managing human resources is the most challenging task for any organisation. The internationalization of businesses across global economy puts additional challenges in managing employees. Managing employees at international level raises complexities as expatriation of employees often lead to relocation of the employee's family as well.

There are three major international HRM activities – Procure, Allocate and Utilize. These three major activities of IHRM cover all the six activities of domestics HRM, i.e., HR planning, Recruiting and Selecting, Training and Development, Remuneration and Compensation, Performance Management and Industrial Relations.

International HRM involves employees of three countries – parent country or the home country (where a company's headquarters might be located), host country (where company's subsidiary may be located) and third country (Other countries that may be sources of labour or finance).The difference between IHRM and domestic HRM can be understood from the following points:

10.14 Difference between IHRM and DHRM

- International HRM encompasses a wide range of activities as compared to domestic HRM. For example, apart from dealing procurement, training and development and performance appraisal of employees, it also includes activities related to cross-cultural & language training programme, and international orientation of employees, whereas such activities are not relevant in case of domestic HRM.

- IHRM is the management of employees who belongs to organizations working in many countries, whereas domestic HRM is concerned with employees working in organizations working in its national boundaries.

- IHRM requires greater involvement in the personal lives of employees by HR manager. The HR manager of a Multinational Corporation (MNC) must ensure that an employee posted abroad has understood all the major aspects of working environment in foreign country, compensation package, and other relevant details regarding taxation and transportation. The HR manager also supports their families in adjusting to a different and new culture by providing cross-cultural & language training.

- On the other hand, in domestic HRM, the involvement of HR manager in the personal lives of employees is very limited. The managers may only be concerned with providing insurance programs or transport facilities to the employee.

- IHRM aims to provide more exposure and learning opportunities to employees by providing various international assignments and also involves high risk and cost. On the other hand, in DHRM the exposure of employees is very limited.

- IHRM has to deal with more external factors and it is very complex and challenging as compared to domestic HRM. For example, in IHRM, the HR managers may have to deal with political figureheads, economic environment and unfavourable economic policies and regulations of the foreign country government. However, in domestic HRM such issues do not arise.

10.15 International Human Resource Activities

10.15.1 International Staffing

International staffing is defined as selecting the right set of people for the right job, at the right time in overseas market. It is not an easy task. It becomes more complex when it comes to operations in host counties. Deciding the right mix of local employees, third country nationals and parent country nationals is very difficult.

- **Cost:** Cost of finding and selecting an international employee is very high. Any errors in selection or selection of a person who do not fit to the job or the organisation could tremendously be expensive for the firm.
- **Compensation and Tax Laws:** are the factors that also affect the decisions in international staffing. Tax treaties between certain countries ease income tax obligations and also make it is easy for the firm to hire employees from certain countries, while it may difficult to hire from others.
- **Environmental factors**: may also affect international staffing because cultural and political environment may be very different for expatriates and may impose difficulty while living there.
- **Cultural Challenge:** Difference in cultures of various nations poses another challenge in hiring international staff. A lot of pre-departure training on cross-cultural environment needs to be provided to the expats.

Sources of Human Resources for International Staffing

Multinational companies can source human resources from the following major sources:

Local citizens or HCNs

Local citizen of host country when hired by an MNE for its operations are called host country nationals or HCNs. Many MNEs employ host country citizens for middle and lower level jobs.

Pros:

- Well aware of the host country business environment
- Familiarity with host country culture and language

- Often less expensive compared to PCNs as are provided with less salary and compensation package comparatively
- Motivates the HCNs and increase prospects of career growth
- Longer duration of stay in the MNE by HCNs leads to continuity of management and improvements

Cons:

- MNEs often fear that it will lead to lack of effective control and coordination over subsidiaries
- HCNs have limited career opportunities as MNCs often do not provide them job opportunities outside the subsidiary

Expatriates

Employees who temporarily reside and work outside their home country are known as ‘expatriates’ or ‘expats’. They may be (i) parent country nationals (PCN) or (ii) third country nationals (TCNs). They work on foreign assignments.

Parent Country Nationals (PCNs)

Employees hired from the home country where the MNE is headquartered are known as PCNs or home country nationals. Generally, MNEs filled up key positions in their foreign affiliates with PCNs.

Pros:

- Well aware with the parent company’s objectives, strategies, policies and practices and culture
- Facilitates higher level of organizational control and coordination
- Availability of highly talented managers with special skills and experiences
- Promising managers from parent headquarters are deputed for international assignments

Cons:

- Employing PCNs is often more expensive compared to HCNs or TCNs as they require more compensation packages

- Difficulty in adapting to host country environment and cultural differences
- HCNs feel de motivated as they cannot get top positions in the organisation

Third Country Nationals (TCNs)

Employees, who are citizens of countries other than the country in which they are assigned to work or the country where the MNE is headquartered, are called TCNs.

In countries with lower level of skill base, such as African and Latin America, MNEs often employ TCNs from countries with cost-effective availability of skilled manpower and professionals from countries such as India rather than from their home country where the workforce is relatively more expensive.

Pros:

- It is easier to find TCNs as global managers with high level of skills and competence
- Cost of employing TCNs is generally lower compared to PCNs
- Trans-national relocation of personnel creates opportunities for career advancement and motivates employees

Inpatriates

Inpatriates are the employees who belongs to either host country or to third country and are assigned to do work in MNEs's parent company (where the headquarter of the MNC is located). The concept of inpatriates is just opposite to expatriate. Today a large number of companies are employing inpatriates to get competitive advantage and develop their global core competencies.

MNEs are increasingly using a right mix of personnel depending on the company's requirement, its objectives, HR strategy, and availability of workforce.

10.15.2 Recruitment and Selection

'Recruitment' refers to the positive process of attracting the most competent people towards the organisation to apply for its jobs.

Whereas ‘selection’ refers to the process by which organizations fill their vacant positions by selecting appropriate person.

The process of recruitment and selection differ across companies and also differ widely among countries. For instance, extensive formal testing and screening techniques are often employed in Asian countries where people are highly test-oriented and comfortable with formal tests.

Characteristics of Global Managers

International Human resource managers are required to be specializing not only in their functional area but also in the understanding of the geographic region of their operations so that they can effectively respond to its specific business demand. They are required to be equipped with multi-lingual and multi-cultural skills and trans-national experience.

The some of the common traits of global managers are summarized as follows:

- **Global mind-set:**

To pursue global business strategies of a firm its managers need to understand the complex and dynamic business environment of not just the country in which firm is operating but also the other global factors that can affect the business need to be understand. The global mind-set is characterized by identifying similarities across diverse countries and adapting business strategies to local conditions. It is today’s demand for managers to ‘think globally, but act locally’.

- **Strategic vision and long-term perspective:**

Global managers should have a strategic vision and be persistent to pursue the long-term goals of the organization. He should not only establish the short, middle and long-term objectives but need to prepare strategies to pursue those goals.

- **Ability to work in diverse cultures:**

International managers are required to work with people belonging to diverse cultural and social backgrounds. Therefore, they should be able to develop a quick understanding of different cultures and should be able to leverage the multicultural environments for the advantages of organisations.

- **Willingness to relocate for international assignments:**

Depending upon the requirements of an MNE, international mangers should be willing to relocate across countries for taking up the challenges of new assignments. MNEs should also trust on employees and provided sufficient autonomy for their work.

- **Ability to manage change**

International managers often come across situations in different countries where they are required to adopt innovative solutions. Therefore, the manager must be capable of adopting the change.

Selection Criteria for International Assignments

An MNE is to consider many factors while selecting personnel for international assignments. Depending upon the company's experience of its international operations and culture, a firm may select the personnel considering following factor:

- **Technical and managerial competence**

Most companies emphasis on technical and managerial skills while selecting the potential managers for international assignments. Academic qualifications, job experience, talent and skills acquired, and past performance of the employees in the company and their previous jobs often serve as useful criteria to assess their competence for international assignments.

- **Ability to perform under cross-cultural environments**

Managers selected for international assignments should be capable of working in diverse cultural environments and work with various stakeholders, such as fellow-employees, customers, and government officials belonging to different background and diverse cultures.

Respect towards the cultures of different stakeholders and their value systems, customs, rituals, traditions, religions, races, emotional maturity and empathy etc are some of the key attributes required to successfully perform foreign assignments.

- **Family attitude towards international assignments**

Support of family members, especially the spouse, is crucial for optimal performance of an employee for taking up an international assignment and performing abroad.

The willingness of families of employees differs significantly due to their apprehensions regarding housing, safety, children’s education, spouse’s career prospects, and also the fear of the unknown in foreign country. Several studies suggest that adjustment of the spouse in the foreign country is highly co-related to the adjustment and the performance of an expatriate.

Most western cultures separate work from employees’ private lives and therefore western MNEs are often reluctant to include the spouse either formally or informally in the expatriate’s selection process. In certain countries, such as Australia, MNEs fear inclusion of spouse in the formal selection process could evoke issues related to individual civil liberties.

Suitability of potential expatriate’s family for an overseas assignment may be appraised through ‘adaptability screening’ which evaluates how well the family is likely to stand up to the rigors and the stress of overseas life.

- **Regulatory framework in host countries**

For international postings, work-permits are required for the selected candidates. MNEs must consider the restrictions imposed by host countries on the foreign nationals. Host country restrictions on relocation of families and freedom to take up any job by the spouse also restrict employees’ decision to accept a foreign assignment.

- **Language**

Working knowledge of foreign languages, especially those of the host country put expatriates on added advantage while selecting managers for international assignments. It facilitates communication of expatriates with the locals in a foreign country.

10.15.3 Training and Development

‘Training’ refers to the process by which employees acquire skills, knowledge, and abilities to perform both their current and future assignments in the organization. Training aims at altering behaviour, attitude, knowledge, and skills of personnel so as to increase the performance of employees.

The need for imparting pre-departure training to spouse and children, besides the employee, is increasingly recognized by MNEs. Pre-departure training is must before arriving for foreign assignments and aimed at smooth transition of expatriates and their families to a foreign location. It includes:

Cultural Sensitization Programmes:

Expatriates and their families need to be aware about the cultural issues at the place of work so that it becomes easy for them to transit smoothly into destination country. It also helps expatriates in dealing with other employees in the host country and managing operations effectively. The type and extent of such training differs across companies depending upon the country of assignment, duration of foreign assignments, nature of posting etc.

Preliminary visit:

Sending employees on a preliminary trip to the host country for orientation often provides a useful insight into their suitability and interest in the overseas assignment. Such pre-departure visits constitute a useful component of pre-departure training along with culture sensitization programmes. It also facilitates during the initial adjustment process of expatriates and helps in reducing the costs associated with expatriate failure.

Language training:

Although English is generally accepted language of global business but it is always desirable for international managers to develop linguistic abilities in the foreign languages of the host country. Ability to understand and speak local languages enhances expatriates' effectiveness and competency to deal with local personnel and their ability to negotiate and manage.

However, the degree of fluency of foreign language required also depends on the level and nature of the foreign assignment and the need for interaction with local stakeholders, such as clients, government officials, and other host country nationals.

Moreover, language skills on the country of operation also help the expatriates and their family members develop social contacts with local communities and evolve their own social support networks.

MNEs from non-English speaking countries tend to use the language of the parent country for intra-firm communications. With the geographical dispersion of its activities, often a common corporate language is evolved which facilitates standardization of information and reporting systems.

As a result, fluency in corporate language also becomes a pre-requisite for effective performance at an overseas assignment. Therefore, pre-departure training should include developing expatriates' proficiency both in the host country and corporate languages.

Practical training:

To assist expatriates and their families relocate overseas, the corporate HRM division often provides information on practical aspects for adaptation to the new environment.

It includes brief working information on the host-country, such as its historical background and geography, economic and legal environments, social and cultural etiquettes, political environment, and the relationship between the two countries and religious beliefs and their impact on daily life and current affairs.

Management development programmes (MDPs) are provided which are aimed at training and developing the managers to harness their fullest potential at job. Type and duration of MDPs vary, depending upon the nature of job, hierarchy level, career and organizational goals.

10.15.4 Performance Management

'Performance management' refers to the process that enables a firm to evaluate the performance of its human resources. The performance is evaluated against pre-defined or standard parameters established, to consistently improve their work performance. The system or method by which the performance of personnel is assessed is known as performance appraisal.

Evaluation of an employee's performance is necessary for assessing employee's contribution to achieve organizational goals and making decisions regarding compensation packages and promotion or transfer, etc.

In the international context, performance appraisal becomes more complex due to many factors such as possibility of conflict between the objectives of an MNE's headquarters and subsidiaries, non-comparability of information between the subsidiaries, the volatility of international markets etc.

Therefore, international HR managers need to reconcile these differences. MNEs need to evolve systematic processes for evaluation of employees from different countries who work in different environments. Developing consistent performance evaluation methods often require taking into consideration the diverse cultural environments of the host countries.

10.15.5 Compensation

Compensation refers to the process of awarding the financial remuneration to the employees in exchange of their services rendered to the organization. It includes wages, salaries, bonus and other monetary package.

A good compensation system should be designed within the regulatory framework of the country of operation of an MNE and should be able to attract and retain the best available talent. Besides, it should be equitable among employees and motivate them to achieve high levels of performance.

Therefore, buying power and inflation prevailing in the country and living standard of the country needs to be taken into consideration while determining wages for employees working in different countries.

Key components of international compensation systems

Base salary:

Generally, an expatriate's base salary serves as a benchmark for other compensation elements. The base salary may be paid either in home country currency or the local currency. It is the basic salary which may be equal to the salary provided to other employees belonging to the same country in which firm is operating.

Foreign Service premium:

To motivate the expatriates to accept a foreign assignment, an extra pay is often offered to expatriates as an inducement, which is known as Foreign Service premium. Such extra premium is paid as compensate to the expatriate for living in an unfamiliar country and working environment, which often isolated them from their friends and family.

Allowances:

It refers to the payments made to expatriates for extra costs required to be incurred for residing overseas. Various types of allowances that form part of expatriate compensation package are discussed below.

Hardship allowance:

It is paid when an expatriate is posted in a difficult location that has lack in basic amenities, such as healthcare, schools, transport, and safety compared to the expatriate's home country.

Cost of living allowance:

Cost of living allowance (COLA) is paid to meet the differences in the price of food, transport, clothes, household goods, entertainment, etc., between expatriate's home country and place of overseas posting. Since it is difficult to precisely determine the COLA, MNEs generally utilises the information provided by specialist organizations.

Housing allowance:

Expatriates are often provided company accommodation or housing allowances to maintain their living standard at home country level.

Home leave allowances:

MNEs often provide paid leave and travel costs to expatriates and their families so as to enable them to visit their home country usually once in a year as a part of their compensation package.

Education allowances:

Allowances for education of expatriates' children are often an integral part of expatriate's compensation package so as to ensure that their children receive the same level of education as in the home country. It may include enrolment fee, tuition fee, fee for language classes, costs of books and stationary, transport, etc.

Relocation allowances:

MNEs often provide travel costs of expatriates and their families and cost of transporting household belongings overseas. Transit accommodation in a company guest house or a hotel overseas is often provided till final housing arrangements are made and the arrival of household goods. It may also include some perquisites, such as car, club membership, domestic help, etc.

Assistance for tax equalization:

Tax equalization refers to an adjustment to expatriate pay to reflect tax rate in the home country. Expatriates generally face income tax liabilities from host as well as from home country.

Sometimes there is a reciprocal tax treaty between the two countries to avoid double taxation. Generally MNEs pay expatriate's income tax in the host country when a reciprocal tax treaty is not in force. Sometimes international firms also make up the difference when the income tax rate in host country is higher which may otherwise reduce expatriate's take home pay.

Home-country-based compensation system:

Under this system, expatriate's base salary is linked to the salary structure of the home country. For instance, salary of an Indian manager posted to the US would be based on the Indian rather than the US level.

It is also known as 'balance sheet approach'. It aims at maintaining the home country living standard for expatriates and their families. It equalizes the purchasing power of expatriates at comparable position levels at the host and the home country and to provide incentives to offset qualitative differences between the job locations.

Host-country-based compensation system:

Expatriate's base salary is linked to the pay structure in the host country. However, other allowances and benefits are linked to the home country salary structure. It is also known as the 'going rate approach', under which the base salary of an expatriate is linked to the prevailing salary structures in the host country.

It is based on information obtained through compensation surveys of locals (HCNs), expatriates of same nationality, or expatriates of all nationalities. However, the basic pay and benefits may be supplemented by additional payments in low-pay countries.

Hybrid compensation system:

It combines the features of both the home- and host-country-based compensation approaches to create a global workforce. It is based on the principle that all expatriates regardless of their country of origin belong to one nationality.

10.16 Check Your Progress

1. Which is not the major objective of International Production Management?

    (A) To increase market share.

(B) To produce the desired product or specified product by specified methods to optimally utilises the available resources in the global markets.

(C) To produce goods at minimum cost by proper planning of the manpower, material and processes available in overseas markets.

(D) To deliver right products in right quantity at right place and at right price to the customers in host countries.

2. Choose the right one related to International Production Strategies.

(A) Production/Factory Location

(B) Factory Design, Layout and Quality Standards

(C) External Vendor and Procurement

(D) All the above

3. In ----------------------approach, all strategic decisions related to subsidiaries and their human resources are made at headquarters. As suggested by Perlmutter:

(A) Ethnocentric

(B) Polycentric

(C) Geocentric

(D) Regiocentric

4. Which one is not the component of nature of International Human Resource Management?

(A) Flexibility

(B) Competitive Environment

(C) Cultural Awareness and Sensitivity

(D) Performance Management

5. The lump sum payments given to employees who move from one assignment to another are classified as?

(A) Ethnocentric Allowance

(B) Mobility Premiums

(C) Hardship Allowance

(D) Foreign Service Premiums

6. Which statement is true about Parent Country Nationals (PCNs) ?

(A) Employing PCNs is often more expensive compared to HCNs or TCNs as they require more compensation packages

(B) Difficulty in adapting to host country environment and cultural differences

(C) HCNs feel de-motivated as they cannot get top positions in the organisation

(D) All of the above

7. Understanding the culture and behaviour of host country's market by host country's manager in cooperation orientation known to be?

(A) Ethnocentric

(B) Polycentric

(C) Geocentric

(D) Regiocentric

8. Employees who temporarily reside and work outside their home country are known as:

(A) Parent Country Nationals

(B) Expatriates

(C) Inpatriates

(D) Local citizens or HCNs

10.17 Summary

International production management deals with production of goods and services in international locations and markets. Production Management is the process of effective planning. It helps in regulating the most important operations of an enterprise that is the actual transformation of raw materials into finished products. The main objective of the international production management is to meet international quality and environment standards, to optimally utilises the available resources in the global markets, to produce goods at minimum cost by proper planning, to forecast demand and production design

International organizations need to consider the following point while developing strategies in host markets: Production/Factory Location; Factory Design, Layout and Quality Standards; External Vendor and Procurement.

International human resource management (IHRM) is the process of managing people worldwide. International human resource management can be defined as the set of activities involved in hiring, managing performance, providing compensation, training and development and managing relations with the employees hired to manage operations of a company in the international markets to ensure the success of strategy of the company.

IHRM is required because it helps in to develop managerial skills, organisational knowledge and technical abilities of employees, to manage and secure the performance, compensation and career path of employees globally, to manage and organise cross-cultural counselling and language-training programme between parent company and subsidiaries as well as among subsidiaries, to develop better and competitive HR strategies in global competitive scenario.

Nature of International Human Resource Management includes **Flexibility, Uncertain Environment, Cultural Awareness and Sensitivity,** Performance Management, **Adaptability to Local Laws, Respect the Diversity**

International Human Resource Activities are International Staffing, Recruitment and Selection, Training and Development, Performance Management, Compensation.

10.18 Keywords

Expatriates

Employees who temporarily reside and work outside their home country are known as ‘expatriates’ or ‘expats’.

Inpatriates

Inpatriates are the employees who belongs to either host country or to third country and are assigned to do work in MNEs’s parent company (where the headquarter of the MNC is located).

10.19 Self- Assessment Test

Q1 Define international human resource management (IHRM). Explain the needs and nature of international human resource management.

Q2 What are the various types of approaches of international HRM? Explain with suitable examples.

Q3 Differentiate between international HRM and domestic HRM. What are the activities and cultural dimensions of international human resource management?

Q4. Do you agree with the statement, "Domestic Production Management is different from International Production Management?" Justify your comments.

Q5 Explain some of the international production strategies that are followed by international organizations in host country.

10.20 Answers to Check Your Progress

(1) A	(2) D
(3)B	(4) B
(5)B	(6) D
(7)B	(8) B

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Subject: International Business	
Course code: MBA-205	Author: Dr Vijender Pal Saini
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International Business Negotiations

STRUCTURE

11.1 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. The objective of this chapter is to get the students acquainted with the basic concepts of international business negotiations.

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**

11.2 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.

11.3 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.

11.4 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.

11.5 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.

11.6 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.

11.7 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.

11.8 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.

11.9 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.

11.10 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.

11.11 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) True

(B) False

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.

11.12 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.

11.13 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.

11.14 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?

11.15 Answers to Check Your Progress

(1) E
(2) C
(3) B
(4) A
(5) A
(6) E

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Subject: International Business	
Course code: MBA-205	Author: Dr Vijender Pal Saini
Lesson no. : 12	Vetter: Prof. Pardeep Gupta
Recent Developments and Issues in IB	

STRUCTURE

12.1 Learning Objectives

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 major developments & issues in international business.

After reading this chapter, students will be able to:

- Describe the concept of globalisation of business
- Explain various issues of international business
- Understand major developments in international business

12.2 Opening Case: Reliance Industries Ltd. (RIL)

Reliance Industries Limited is a Fortune Global 500 company (Ranked 106 in 2019) and the largest private sector corporation in India. The company is in the business of Crude Oil Exploration & Production, Petroleum Refining & Marketing, Textile, Petrochemicals, Retail and Telecom. The company’s commitment to sustainable development goes beyond our operating boundaries, as we continuously aim to add value to our stakeholders by advancing knowledge and improving lives. Oil to telecom behemoth is slowly transitioning from an energy-centric conglomerate to one focusing increasingly on consumer technology.

Reliance Jio Infocomm Limited (388 million subscribers) is an Indian telecommunication company and subsidiary of Jio Platforms. Jio Platforms, a unit of RIL comprises mostly its telecom businesses. Jio Platforms includes Jio Cinema, Jio Saavn, Haaptik. RIL has over the last 6-12 months consistently talked about building Jio Platforms into a digital platform on the lines of US technology companies like Tencent and major giant Alphabet Inc. (Alphabet Inc. is an American multinational conglomerate headquartered in Mountain View, California. It was created through a restructuring of Google on October 2, 2015, and became the parent company of Google and several former Google subsidiaries)

Reliance Jio Platforms gets Rs 168,818 crore investment in just 58 days through (i) Investments by global tech investors - □ 115,693.95 crore (ii) Rights Issue □ 53,124.20 crore and become net debt-free company. The sequence of events as follows:

- **April 22, 2020:** Facebook, Mark Zuckerburg's Facebook (American Social Media Conglomerate Corporation based at California) announced an investment worth Rs 43,574 crore in Reliance Jio. This roughly accounted for 9.99 per cent stake in Jio Platforms.
- **May 4, 2020:** Silver Lake, Silver Lake (US based Private Equity Investor, Founded in 1999, Silver Lake is a pioneer in global technology investing. Today, Silver Lake's portfolio of investments

collectively generates more than $204 billion of revenue annually and employs more than 356,000 people globally.) invested 5,655 crore into Reliance Jio for a stake of 1.15%.

- **May 8, 2020:** Vista Equity (US-based private equity firm) invested 11,367 crore in Jio Platforms for a stake of 2.32 per cent.
- **May 17, 2020:** General Atlantic (US-based) invested Rs 6,600 crore into Jio Platforms for a stake of 1.34%.
- **May 22, 2020:** KKR (New York based equity firm) announced 11,367 crore investment in Jio Platforms for 2.32 per cent equity stake.
- **June 5, 2020:** Mubadala, (Abu Dhabi based investment company) announced infusion of Rs 9,093 crore into Jio platform.
- **June 7, 2020:** Abu Dhabi Investment Authority invested Rs 5,683.50 crore and took 1.16 per cent share in company.
- **13th June 2020:** TPG (California based PE fund) invested Rs. 4,546.80 crore and took 0.93 per cent share in company.
- **13th June 2020:** L Catterton (American private equity company based in Greenwich, Connecticut, has over $15 billion of equity capital) invested Rs. 1,894.50 crores and took 0.39 per cent share in company.
- **18th June 2020:** PIF (The Public Investment Fund is the sovereign wealth fund of Saudi Arabia. It is among the largest sovereign wealth funds in the world with total estimated assets of $320 billion) invested Rs. 11,367.00 crore and took 2.32 per cent share in company.

12.3 Introduction: 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.

12.4 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.

12.5 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.

12.6 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.

12.7 Check Your Progress

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.

Fill in the Blanks:

6) Relience industries Ltd (RIL) ranked______in 2019 over 500 global companies.

7) Spyware/Torjans/Ransomware/Phishing are the examples of the____________ crime.

8) Fixing quota is _______________barriers in international business.

9) FDI & FPI are _____________ modes to enter in international business.

Objective Type Questions:

(10) Which organisations strain on the liberalisation of foreign investment and foreign trade?

(A) International Monetary Fund

(B) World Health Organisation

(C) World Trade Organisation

(D) International Labour Organisation

(11) Intellectual Property Rights (IPR) protect the use of information and ideas that are of:

(A) Ethical value

(B) Moral value

(C) Social Value

(D) Commercial Value

(12) Which legislation relates to the concept of business ethics?

(A) Freedom of Information Act

(B) Food Act

(C) Building regulations

(D) All of these

(13) Most companies begin the process of establishing organizational ethics programs by developing:

(A) Ethics Training Programs

(B) Codes of Conduct

(C) Ethics Enforcement Mechanisms

(D) Hidden Agendas

12.8 Summary

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.

12.9 Keywords

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.

12.10 Self- Assessment Test

Q. 1 What are the major developments in international business? Elaborate.

Q. 2 Write down the ethical and social responsibility issues of international business.

Q. 3 What do you mean by globalization? Elaborate the different fields of globalisation.

Q. 4 Explain important issues in international business.

Q. 5 Discuss the recent developments in international business with suitable examples.

Q. 6 Write a short note on following:

- Intellectual Property Rights
- Cyber Specific Issues

12.11 Answers to Check Your Progress

(1) True	(2) False
(3) True	(4) False
(5) True	(6) 106th
(7) Cyber	(8) Non-tariff
(9) Investment mode	(10) C
(11) D	(12) A
(13) B	

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Subject: International Business	
Course code: MBA-205	Author: Dr Vijender Pal Saini
Lesson no. : 13	Vetter: Prof. Pardeep Gupta
Multinational Corporations (MNCs)	

STRUCTURE

13.1 Learning Objectives

Multinational Corporation (MNC) is an enterprise with a substantial part of its operations in a number of foreign countries. The objective of this chapter is to get the students acquainted with classification, features, organisation, and limitations of Multinational Corporation.

After reading this chapter, students will be able to:

- Describe the concept of Multinational Corporation
- Explain various advantages and disadvantages of Multinational Corporation
- Understand reasons of attraction of MNCs in India
- Comprehend the future of MNCs in India

13.2 Introduction: Multinational Corporations

A multinational corporation (MNC) is defined as a corporate organisation which owns or controls production of goods or services, having facilities, offices and other assets in at least one country other than its home country. These companies are headquartered in one country and from there, these companies operates their subsidiaries at global level. These companies are also known as international, stateless, or transnational corporate organizations. MNCs are very large organisations which produce or sell goods & services in many countries. Some multinational companies are having budgets that are more than the GDP of many small countries.

In other words, any company that operates in more than one country at a time is known as multinational company. Generally, the corporation has its headquarters in one country and it controls as wholly or partially owned subsidiaries in other countries. All of its subsidiaries are liable to report to the corporation's central headquarters. So, there are two main characteristics of MNCs (i) large size and (ii) control over businesses worldwide by parent companies.

13.3 History and Evolution of MNCs

The history of the multinational corporation goes back to the origin of trade between civilizations and communities. The evidences of trade between countries are found from the ancient remaining by archeologists. Evidences of trade between Asia and other continents through Silk Route have been found. Trade among countries has reached its apex with the multinational corporation. These are involved in all three modes of international business: international trade, portfolio investment, and foreign direct investment.

Generally, International business between two or more countries begins with the exchange of goods (international trade) and reaches to its second stage with the partial exchange of the tangible assets of one company for the capital assets of another (portfolio investment). The third stage originates when the company acquires another entire company or the establishment of productive facilities owned and managed by a firm which has economic interests in more than one country (foreign direct investment). International business finally reaches its final stage when the corporation is involved in all three modes of international business: international trade, portfolio investment, and foreign direct investment.

13.4 Definition of Multinational Corporation (MNC)

Multinational Corporation (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.

Black's Law Dictionary defines a multinational corporation as “a company or group should be considered a multinational corporation if it derives 25% or more of its revenue from out-of-home-country operations. However, a firm that owns and controls 51% of a foreign subsidiary also controls production of goods or services in at least one country other than its home country and therefore would also meet the criterion, even if that foreign affiliate generates only a few percent of its revenue.” 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". As for example McDonalds operates in more than 110 countries and are owing more than 35000 restaurants all across the world.

13.5 Classification of MNCs

- **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**

For Regiocentric firms region becomes the relevant geographic unit (rather than by country).

- **Geocentric Firms**

Geocentric firms maintain a balance between the home market and host market oriented policy.

13.6 Features of MNCs

A multinational company is incorporated in one country/home country and having businesses/operations in many countries/host countries. MNC is sometimes called global company, international company, world enterprise, transnational company. There are many MNCs working in India like Unilever, Bata Corporation, Cadbury, Colgate Palmolive, Sony corporation, LG, Philips, Proctor and Gamble, Bata Corporation, Suzuki, etc. The list is very long. Generally, MNCs are rich in resources like skilled manpower, best quality raw material, latest & automated machines and access to cheapest sources of funds. The MNCs are having production in many host countries. MNCs operate in through a network of affiliates, branches and subsidiaries in host country. As for example, Unilever (Headquarters in London, UK) is working through its subsidiary named Hindustan Lever in India. Bata Corporation (Lausanne, Switzerland) has its subsidiary named Bata India and Suzuki (Japan) has affiliate named Maruti Suzuki in Indian market.

The following are the features of multinational corporations:

1. Very High Assets and Turnover

MNCS are full of resources like competent, capable, skilled & trained manpower, best quality raw material, abundant amount of funds, huge physical & financial assets, latest technology and latest machines. MNCs are having wide experience, innovated products & services, hi-tech research & technology labs, good reputation or goodwill in the market. Goodwill helps MNCs to attract talented managers, fund managers, etc and MNCs are able to enjoy good bargaining power while dealing with other businesses.

2. Network of Subsidiaries/Affiliates

Multinational companies have network of branches, offices, subsidiaries and affiliates in other countries. MNCs owns and runs value added actives such as mining, production, sales outlets, offices, plantation, communication & IT enabled services, agriculture, logistics, transportation, supply chain management and marketing operations in different countries.

3. Control and Management

The management of the offices in other countries is done by the central head office that is usually located in home country. MNCs own or exercises control over its associate companies in overseas markets. Business affiliates and management in the subsidiary in host countries are run by their own management but the ultimate control remain in the hand of head office.

4. Growth Prospects

Multinational corporations operate in other countries and keep working on enhancing their economies of scale by consistently upgrading and adopting research & development activates, and innovations. MNCs keep on increasing their sizes through joint ventures, contracting, licensing, franchising, mergers and acquisitions abroad.

5. Sophisticated Technology

MNCs are having huge amount of wealth and investments. The MNCs make extensive use of capital-intensive technology like automation, robotics, and artificial intelligence especially in the field of production, marketing, retailing, operations, logistics, and supply chain management to get economies of scale. It provides ultimate competitive advantage to MNCs the market.

13.7 Organization of MNC

Multinational companies generally face difficulty while organising the structure of their organization. They require an organisational structure that goes for differentiation which allows them to be specialized and competitive in their local markets. They also work to integrate the structures of various subsidiaries operating in other countries to find a balance. Multinational companies therefore adopt many structures that suit to their business requirements.

Subsidiary Model

It is one of the most commonly found structures of Multinational corporations. The subsidiaries are independent unit with their own operations, finance, human resource and product and marketing strategies. However the major disadvantage of this model is the decentralization of strategic decisions which makes difficult for the implementations of central decisions and policies.

Product Division

On the basis of product portfolio, separate division is established for each product. Production, marketing and financial decisions related to each product are taken by each division. It allows the multinational company to exit out the product divisions that are not earning well. The major disadvantage of this divisional structure is the lack of integration of activities that may increase duplication of activities across countries.

Area Division

The whole activities of the organisation are divided on the basis of geographical area. Each geographical region is responsible for all the products sold within its region. This structure allows the company to evaluate and compare the performance of different geographical markets that are earning more profits.

Functional Structure

The classification is based on organisational functions such as finance, operations, marketing and human resources. For example, all the production personnel and human resource globally for a company work under the standards set by the production department.

13.8 Advantages of MNCs

Access to Consumers

Access to large geographical regions allows the MNCs to have a larger customer base.

Accesses to cheap Labor

MNCs enjoy access to cheap labor across all over the world. Many developed countries employ the cheap labor available in Indonesia, China, India, Pakistan etc.

Benefits to Host country

The investment made by MNCs lead to increase in employment level and income level of the host country. MNCs also provide technology up gradation to host country.

R&D

MNCs help in improving the R&D for the economy which also provides benefit to host countries.

Exports & Imports

MNC operations also help in improving the Balance of payment of home and host country as well. This can be achieved by the increase in exports and decrease in the imports.

13.9 Top 10 MNCS of Fortune Global 500 List 2019

Name of Company	Revenues ($M)
1.Walmart	$514,405
2. Sinopec Group	$414,649
3. Royal Dutch Shell	$396,556
4. China National Petroleum	$392,976
5. State Grid	$387,056
6. Saudi Aramco	$355,905
7. BP	$303,738
8. Exxon Mobil	$290,212

9. Volkswagen $278,341

10. Toyota Motor $272,612

13.10 Fortune Global 500 List 2019: Country wise

Rank	Company	Country	Industry	Revenue in USD
1	Walmart	United States	Retail	$514 billion
2	Sinopec Group	China	Petroleum	$415 billion
3	Royal Dutch Shell	Netherlands United Kingdom	Petroleum	$397 billion
4	China National Petroleum	China	Petroleum	$393 billion
5	State Grid	China	Energy	$387 billion
6	Saudi Aramco	Saudi Arabia	Energy	$356 billion
7	BP	United Kingdom	Petroleum	$304 billion
8	Exxon Mobil	United States	Petroleum	$290 billion
9	Volkswagen	Germany	Automobiles	$278 billion
10	Toyota Motor	Japan	Automobiles	$273 billion

13.11 Examples of MNCs in India

Many multinational corporations have invested in India since the adoption of new economic policy in 1991. For example:

Microsoft

Microsoft Corporation India Pvt. Ltd is a subsidiary of software giant Microsoft Corporation based at Redmond, Washington, United States established in 1975. Microsoft Corporation began its operations in Indian headquarter at Hyderabad in 1990. It has its offices in major cities in India and work with the objectivity to become partner with Indian government and supporting IT industry. It is indeed one of the most popular in the list of MNCs in India. Today, Microsoft entities in India have over 8,000 employees, engaged in sales and marketing, research and development and customer services and support, across 11 Indian cities – Ahmedabad, Bangalore, Chennai, New Delhi, Gurugram, Noida, Hyderabad, Kochi, Kolkata, Mumbai and Pune.

IBM (International Business Machines Corporation)

IBM India Private Ltd is subsidiary of giant MNC International Business Machines Corporation (Armonk, New York, United States) in India. It started its operations in the year 1992 in India and established its Indian headquarter at Bangalore. It provides a range of products and services including business consulting, storage solutions, etc.

Nestle

Nestle India which is a food and beverage company from Switzerland is a part of Nestle S.A. Nestle had made its entry into the market in the year 1912 with improved products and is currently one of the most leading MNCs in India. It is considered as one of the largest food company in India with its best food products. IT also comes with the rank 72 on the Fortune Global 500 in the year 2014 according to the revenue.

Proctor & Gamble

The Procter & Gamble (P&G) company is a transnational consumer goods corporation headquarter in Cincinnati, Ohio and was started by William Procter & James Gamble in 1837. The MNC made its way into India in 1964 and currently has products ranging from detergents, shampoos, sanitary napkins, razors, etc., in the product categories of Oral Care, Personal Health Care, Skin Care, Hair Care, home Care, Fabric Care, Feminine Care, Baby Care. It has very famous brands which are household names like Pampers, Whisper, Head & Shoulders, Pantene, Olay, Old Spice, Gillette, Oral-B, Vicks, Arial, Tide etc. It has a wide range of products including beauty, grooming health and household care etc.

Coca-Cola

Coca-Cola Company is an American MNCs based at Atlanta, Georgia is a very famous MNC in India. Coca-Cola is a household name in India. It started operation in India in 1993. Coco-Cola manufactures and is big marketer of non-alcoholic beverage concentrates and syrups. The company operates in India as a subsidiary named Coca-Cola India Private Ltd. It has leading brands like Coca-Cola, Thumps Up, Fanta, Sprite, Diet Coke, Limca, Maaza in India.

PepsiCo

PepsiCo is an American Company found in 1965. It operates in India through its subsidiary, Pepsico India Holding Private Limited. It is well-known manufacturer of snacks and beverages. It is a leading manufacturer of popular brands such as Slice, Pepsi, Mirinda, Mountain Dew, Lays, Uncle Chipps, Tropicana, Quaker Slice in India.

CITI Group

Next one on the list of MNCs in India is the CITI Group, founded in 1998, an American Banking services Corp. It operates in India through its subsidiary, Citibank, which presently has more than 40 branches in over 30 cities in India. The MNC have corporate office in Manhattan, New York City and revenue is US$ 76.88 billion and Its headquarter in India is in Mumbai. Citibank has more than 700 ATMs in India. Interestingly, Citibank was formed by one of the largest mergers in the history and now owns the world's largest financial services.

SONY Corporation

Sony is yet another well-known Japanese multinational company which came into existence in the year 1946. Sony Corporation began its operations in the year 1994 and is well acclaimed for its products in various categories: electronics, media and entertainment. Televisions, mobile phones, cameras, PlayStations, headphones, memory card, etc. are the major products of the Sony Corporation. It's headquarter in India is situated in Delhi, India with the total revenue of US$ 153.683 billion.

Hewlett Packard (HP)

HP was started off in the year 1939 and has it's headquartered in Palo Alto, California and having the revenue US$ 111.454 billion. HP has also made its way into the list of MNCs in India with its products ranging from laptops, monitors, desktops and other electronic items. Hewlett Packard is electronics and Information Technology Company and its headquarters in India is in Bangalore. HP produces line of printers, digital cameras, scanners, PDAs, calculators, servers, workstation computers, and computers for home and small-business use. Many of the computers came from the 2002 merger with Compaq.

Apple Inc

Apple Inc., an American Multinational Company was founded in the year 1976. The MNC deals with laptops, phones, software and various online services in India. The company is well-renowned for electronic consumers and some of their best selling products such as iPhone, iPod, iPad, and Mac. This is one of the largest MNC's companies in India which develops and sells computer, laptops, software and online services.

13.12 Reasons of Attraction of MNCs in India

Fastest Growing Economy

India is the 5th largest economy and its fastest growing economy. According to IMF, India is among the top five countries to grow fastest in the world. Hence, big MNCs invested in India.

Growth of Customers with Increasing Disposable Income

India is having 2nd largest population after China with 1.371 billion people. By 2030, India's middle class is expected to grow to reach 475 million. The increase of the middle class income group in India implies that more people will be able to afford the goods sold by the companies moving operations to India.

Labour Competitiveness

India is having the 2nd largest population in world and having a large number of skilled as well as English spoken young populations. This is available at cheap rates to MNCs.

FDI Attractiveness

India's rank in 'Ease of Doing Index' is improving day by day which implies it is providing India's efforts to simplify and reducing paper work and bureaucratic hurdles on the way of business.

13.13 Criticism of MNC

Restrictive laws

MNCs are subjected to face stringent laws and regulations than domestic companies. Some countries do not allow MNCs to run its operations or impose certain conditions on them, i.e., use of domestic accessories compulsory. MNCs remain worried consistently about stringent government policies, tax structure, rigid environmental laws, compulsory certificate requirements, tariff & non-tariff barriers, consumer protection laws etc., in host countries.

Issues related to Intellectual Property

Multinational companies also face issues regarding the intellectual property. Many intellectual property rights protections are not available in some countries. MNCs are consistently worried about their investments made on research & development and innovations.

Political Risks

MNCs are generally faced with political and economic instability.

Transfer Pricing

This is the most commonly criticism of MNCs. This practice is used to reduce their tax liability in those countries that may have a higher tax rate for their products and increase their liability in countries with a lower tax rate.

Foreign Control over Key Economic Factors

Foreign companies get control over the key resources of the host country.

Environmental Impacts

MNCs are alleged globally for harming and exploiting environmental resources.

13.14 Future of MNCs

The increasing wave of globalisation, economic reforms and innovations in information technology has lead to the possibilities of big spread out of MNCs all over the world. Economic integration is a multi-dimensional phenomenon which encompasses merchandise trade, services trade, cross-border investments, and data flows. The whole world is like a village. The future trends of MNCs will continue to enhance the integration and co-operation among nations and contribute to the dynamism and growth of the global economy. However, issues like Brexit and some countries stance of protectionism of domestic companies leads to “De globalization” create worries.

13.15 Check Your Progress

State whether the following statements are True or False:

1. MNCs own or controls production or service facilities outside the country in which it is based.

2. Geocentric firms adopt home market oriented policy.

3. MNCs diversify risk through internationalization.

4. Many companies are crossing borders because the cost of human resource is rising.

5. The investment made by MNCs lead to increase in unemployment level.

6. MNCs join hands with big business houses and give rise to monopoly and concentration of economic power in host countries.

Fill in the blanks:

7. ________________firms follow a host market oriented policy.

8. Separate division is established for each product is called_____________________.

9. Sony is a MNC with its origin in__________________ .

Multiple Choice Questions:

10. Which one of the following is not the advantage of MNCs to the host country?

(A) Increase in social activity (B) Increase in economic activity

(C) Utilisation of natural resources (D) R&D efforts enhanced

11. An MNC that maintains a balance between the home market and host market oriented policies is:

(B) Polycentric firm (A) Ethnocentric firm

(C) Geocentric firm (D) None of the above

12. A company which has business operations in at least one foreign country is called:

(A) Multinational Company (B) International Company

(C) Transnational Corporation (D) Global Corporation

13. A company which views the whole world a single homogenous market and caters to the global market through globally standardized products are called:

(A) Multinational Company (B) International Company

(C) Transnational Corporation (D) Global Corporation

14. Which of the following is disadvantage of MNCs for host country?

(A) Disregard of National Goals

(B) Creation of Monopoly

(C) Threat to National Sovereignty

(D) All of above

13.16 Summary

A multinational corporation (MNC) is defined as a corporate organisation which owns or controls production of goods or services, having facilities, offices and other assets in at least one country other than its home country. These companies are headquartered in one country and from there, these companies operates their subsidiaries at global level. These companies are also known as international, stateless, or transnational corporate organizations.

Classification of MNCs are: Ethnocentric Firms, Polycentric Firms, Regiocentric Firms, and Geocentric Firms.

The following are the features of multinational corporations: 1. Very High Assets and Turnover, 2. Network of Subsidiaries/Affiliates, 3. Control and Management, 4. Growth Prospects, and 5. Sophisticated Technology.

Multinational companies adopt many structures that suit to their business requirements like: Subsidiary Model, Product Division, Area Division, and Functional Structure.

Advantages of MNCs are Access to Consumers**,** Accesses to cheap Labor**,** Benefits to Host country, and R&D.

Examples of MNCs in India are Microsoft, IBM (International Business Machines Corporation), Nestle, Proctor & Gamble, Coca-Cola, PepsiCo, CITI Group, SONY Corporation, Hewlett Packard (HP), Apple Inc. etc.

Reasons of Attraction of MNCs in India are Fastest Growing Economy, Growth of Customers with Increasing Disposable Income, Labour Competitiveness, and FDI Attractiveness.

Criticism of MNC are **Restrictive laws** , Issues related to Intellectual Property, Political Risks, Transfer Pricing, Foreign Control over Key Economic Factors, and Environmental Impacts.

13.17 Keywords

Multinational Corporation (MNC)

A multinational corporation (MNC) is defined as a corporate organisation, headquartered in one country & operates their subsidiaries at global level. It owns or controls production of goods or services, having facilities, offices and other assets in at least one country other than its home country.

13.18 Self- Assessment Test

Q.1 Define the characteristics of a multinational corporation (MNC).

Q.2 Explain the meaning and forms of multinational corporations.

Q.3 Discuss the factors that contributed to the growth of MNCs. Use suitable examples.

Q.4 Elaborate the reasons of attraction of MNC in India with examples.

Q.5 "Situational factors determine the form adopted by an organisation for business in other countries." Explain the statement.

Q.6 Elaborate the organisation structure of an MNC.

Q.7 Elaborate the MNCs criticism with examples.

Q.8 Explain the meaning and current scenario of multinational corporations in India.

Q.9 What are the advantages and disadvantages of multinational corporations?

Q.10 "A multinational corporation has to face various cultural issues." Explain the statement.

Q.11 Identify and analyze the issues of conflict that arise from MNC policies and practices in host countries.

13.19 Answers to Check Your Progress

(1) True (2) False

(3)True (4) True

(5) False | (6) True
(7) Polycentric | (8) Product Division
(9) Japan | (10) A
(11) C | (12) B
(13) D | (14) D

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Subject: International Business	
Course code: MBA-205	Author: Dr Vijender Pal Saini
Lesson no. : 14	Vetter: Prof. Pardeep Gupta
Technology Transfers, Strategic Alliances, Mergers and Acquisitions	

STRUCTURE

14.1 Learning Objectives

The objective of this chapter is to get the students acquainted with the knowledge of Technology Transfers, Strategic Alliances, Mergers and Acquisitions.

After reading this chapter, students will be able to:

- Describe the concept of concept and process of technology transfers
- Explain types, risks, advantages, disadvantages of strategic alliances
- Understand reasons of mergers and acquisitions

14.2 Introduction: Technology Transfer

Technology transfer (TT) is the process of conveying the scientific and technological research results to the market place and providing benefits to wider society, along with associated skills and procedures. It is an intrinsic part of the technological innovation process.

Technology transfer is a complex process because it not involves technological and scientific factors but non-scientific and non-technological factors, and many different stakeholders also form part of it. The reason being that good or high quality innovation is not enough for successful technology transfer but general awareness and willingness among the various stakeholders and interested parties as well as skills and capacity related to specific issues, i.e., access to finance and intellectual property (IP) management and risk-taking are also important part of it.

Technology transfer, also known as tech transfer, is the process by which inventions and innovations are turned into products and commercialized in the market.

This is generally done in two ways: through licensing patented intellectual property to corporations, and the creation of start-up companies, which also often license the intellectual property created by owner.

14.3 Technology Transfer Process

Technology transfer process includes the complex value chain that links research to its societal deployment.

- This process begins with the discovery of novel technologies and innovations at research institutions and labs, and is followed by the disclosure, evaluation and protection of these technologies through various laws such as Patent Act, Copyright Law, etc.
- The next step is to socially deploy the innovations in the form of products and services. It includes marketing, potential licensing agreements and the development of products based on the technical inventions.
- The financial returns of these products are used for further research.

14.4 Technology Transfer in International Business

Technology transfer in case of international business covers various activities, including the inter-departmental transfer of technology, i.e., from the R&D or engineering department to the manufacturing department of a firm based in a country, same transfer of technology from a laboratory or operations of a MNCs in one country to its laboratory or operations in another country. It also includes the transfer of technology from a research consortium supported by many firms to one of the members.

Thus a technology, expertise, knows how or facilities developed by one business organization (MNC in the case of international business) are transferred to another business organization. There are many issues associated with the international technology transfer, i.e., ways of technology acquisition, choice of technology, terms of technology transfer, and creating local capability etc.

Thus technology transfer can be defined as a process that permits the flow of technology from a source to a receiver. The source may be the owner or the holder of the knowledge or technology and it can be individual, a company, or a country, whereas the receiver is the beneficiary of the transfer technology.

Technology can be transferred through published material, purchase and sale of machinery, equipment, providing the use of a particular formula and intermediate goods, transfer of data and personal and interpersonal communication.

Technology transfer in international business can be categorised in six categories:

(a) **International Technology Transfer**, in which the transfer took place across national boundaries. For example, technology transfers between developed and developing countries.

(b) **Regional Technology Transfer**, in which technology is transferred from one region to another. For example, the transfer between EU and NAFTA.

(c) **Cross-industry or Cross-sector Technology Transfer**, in which technology is transferred from one industrial sector to another.

(d) **Inter-firm Technology Transfer**, in which technology is transferred from one company to another.

(e) **Intra-firm Technology Transfer**, in which technology is transferred within a firm, from one location to another. Intra-firm transfers can also be made from one department to another within the same facility.

(f) **Pirating or Reverse-Engineering**, whereby access to technology is obtained by violating the property rights of the owners of technology.

14.5 Parties Involved in the Technology Transfer

International technology transfer has both horizontal and a vertical dimension, each with its own elements.

- From the horizontal perspective, the parties involved in technology transfer are: the home country, the host country and the transaction.
- The vertical dimension of technology transfer refers to the issues pertaining to a particular nation or a state, or to the industries or firms within the home and host countries.

14.6 The Implications of Technology Transfer

1. Home Country Implications

Home countries usually oppose the export of technology because the establishment of production facilities in subsidiaries by MNCs abroad, sometimes negatively affects their export potential. Additionally some MNCs imports products produced from technology exported from their subsidiaries which results in increase in the volume of imports of the home country. Thus, the decrease in exports and increase in imports may impose adverse impact on the balance of trade of the home country.

Besides it, technology transfer may affect the comparative advantages of the country. Labor unions in the home country too oppose technology transfer arguing that the jobs generated from the new technology will benefit the country citizen, therefore should not be exported.

2. Host Country's Implication

The implications for host country due to technology transfer are based on economic and social factors.

- **Economic Implications**

It includes payment of fee, royalty, dividends, interest and salaries to technicians and tax concessions, etc., which negatively affect the national exchequer. All these are payable to the transferring country and generally are very expensive to the host country. In addition to the payments just stated, the technology supplier also results in extracting payments through various other techniques like over-pricing and buying intermediate goods at high prices, tie-up purchase, restriction on exports, and charging excessive prices.

Many times, the technology transferred by developed countries to developing countries is not appropriate or of sub standard level (which is obsolete for developed countries).

- **Social Implications**

The social and cultural implications of technology transfer include transmission of culture from the exporting countries.

Modes of Foreign Technology Acquisition

Technology transfer can be done in various ways. New technology comes from many different sources, i.e., from suppliers, manufactures, industries, universities, government research institutions and MNCs. Different organisations have different ways of acquiring technologies. In many industries, however, the primary sources of new technologies are the organizations that use the technology. Broadly the acquisition routes are three:

- **Internal Technology Acquisition**

Internal technology acquisition which occurs in a firm requires the existence of a research and development facility in the company. Internal technology development has the advantages that any innovation and invention becomes the exclusive property of the firm.

- **External Technology Acquisition**

External technology acquisition is the process of acquiring technology that is developed by others for use in the company. External technology acquisition provides the organisation the advantage of reduced cost and time implement and lower risks. However, technology available from outside sources is developed for different applications.

- **Hybrid Sources**

Technology acquisition can be done through combinations of external and internet technology acquisitions. Combined acquisitions overcome some of the limitations and take some advantages of the both the external and internet technology acquisitions at the same time.

14.7 Making Decision on Technology Transfers

The technology transfers require the following decisions to be made at managerial level:

1. **Getting Internal Technology First :** Taking advantage of knowledge available in- house facility of firm is least expensive and has no risks. Technology acquisition via internal R&D facility consists of having a research and development group within the firm. This source of technology acquisition enables the firm to become stronger and provide exclusivity and sometimes it may provide tax concessions via government incentives. However, long time required in research & development, high cost and risk of failure are the demerits of this internal route of technology acquisition.

2. **Internal R&D with Networking:** Internal R&D networking has all the same advantages and disadvantages discussed under internal R&D. The main difference is the fact that the R&D staffs makes a fairly concerted effort to keep abreast of the state of development of the technologies affecting their products. They network with technology creators at conferences and trade shows.

3. **Reverse Engineering:** Reverse Engineering is the process of determining of the technology embedded in a product through rigorous study of its attributes. It entails the acquisition of a product that the firm believes would be an asset, disassembling it, and processing of its components to a series of tests and engineering analysis to ascertain how it works and studying the engineering design criteria used in the product's creations.

4. **Reverse Brain Drain:** This method involves attracting expatriate entrepreneurs and experts who have gained adequate experience abroad to set up or develop enterprises in their countries of origin. Taiwan and China are the countries which usually adopt this type of technology transfer.

5. **Secret or Hidden Acquisition with Internal R&D:** It entails the process of finding out the technology developments processes being conducted by a competitor that are not open to the public. Most businesses do this to cope up with the competitors and are done by questioning suppliers about components being sold to the competitors or by socializing with the competitor's employees.

6. **Covert Acquisition:** This process requires that the product will be a copy (generally a poor one) of the competitor's product. The firm can introduce it at a lower price because there are no development costs to recover. However, with the exception of the price, the product will have no other competitive advantage.

7. **Technology Transfer and Absorption:** This route is similar to internal R&D with networking except there is much more efforts put into searching for, learning about, and translating, no-cost technology to the firm's applications. However, internal technical ability is also necessary to understand the technologies found and to develop them into solutions for the firm's application.

8. **Contract R&D:** This is the ideal option for those firms that lack the necessary facilities and expertise to conduct the required research and innovation but still want to maintain control over the development and own the results exclusively. This method avoids the investment in facilities required to conduct research and the on-going commitment to staff that would be underutilized. It allows short-term access to world class personnel and facilities for specialized projects that would otherwise be completely beyond the company's means. The advantages of this route are no/less investment in facilities and equipment and in staff.

9. **R&D Strategic Partnership:** R&D strategic partnerships are almost the same as contracting R&D. This method generally consists of a group of companies with a common need that collectively contract a research institution to conduct the work for them. It allows the firms to share the risk and costs. The advantages of this route of technology acquisition are: shared risks, reduced cost, and possibility of learning from the work of others. Need to share knowledge with others is the drawback of this route.

10. **Licensing:** Another route of technology acquisition is licensing. Its major benefit is a significant reduction in time to market relative to other forms of technology acquisition that require development. It also enables the acquiring firm to share the financials risks of acquiring the technology with the provider because the payments are made generally as royalty or license fees which is a percentage of sales of product made using the new technology.

11. **Purchasing:** A common and effective external technology acquisition method is purchasing generally buying a piece of production machinery with embedded technology. The technology is already packaged and is ready for use, thus it can be quickly acquired.

12. **Joint Venture:** Entering into a joint venture agreement with a technology provider is effective way of acquiring technology. This is a partnership between two firms generally involving one firm with a technology and another having market access. The advantages are that risk involved is less and are possibilities of learning from the provider of technology.

13. **Acquisition of a Technology Rich Firm:** The final form of external technology acquisition is the acquisition of a firm having the knowhow and that is technology-ridden. This acquisition may be the result from a defensive action to protect itself from competition or it can be deliberate strategy to acquire technology. Advantages of this method are: low risk, and profitability of buying good image firm.

14.8 Strategic Alliances

Strategic alliances are kind of agreements between two or more independent companies to cooperate in the field of manufacturing, development, or sale of products and services or other business activities. In strategic alliance companies combine their respective resources, capabilities, and core competencies to generate mutual interests in designing, manufacturing, or distributing goods or services or other business activities.

Example: The agreement between Spotify and Uber is an example of strategic alliances. These two companies have targeted towards increasing their customer base through this alliance.

In this way, both companies are getting an edge over their competitors. Customers of Spotify can play their favourite playlist while riding in the Uber ride by getting the premium package of Spotify.

14.9 Types of Strategic Alliances

There are three types of strategic alliances: Joint Venture, Equity Strategic Alliance, and Non-equity Strategic Alliance.

1. Joint Venture

A joint venture is a form of strategic alliances in which the two companies join hands to conduct a particular activity or to do business. For example: The agreement between two companies to build a highway.

2. Equity Strategic Alliance

An equity strategic alliance is created when one company purchases equity share of the other company in a certain number or portion. For example if Company A purchases 40% of the equity share of Company B, an equity strategic alliance is formed.

3. Non-equity Strategic Alliance

A non-equity strategic alliance is created when two or more companies agree to sign a contractual relationship to pool their resources and capabilities together.

14.10 Reasons for Strategic Alliances

Companies form strategic alliances because of three product life cycles: Slow cycle, Standard cycle, and Fast cycle. Different product life cycles have different need to innovate and continually create new products in an industry.

1. Slow Cycle

In a slow cycle, the company's competitive advantages are protected for relatively long periods of time. For example, the pharmaceutical industry generally operates in a slow product life cycle as the products are developed over the years after long-time experimentation and therefore patents last a long time.

Strategic alliances are therefore formed to gain access to a restricted market, maintain market stability and for establishing a franchise in a new market.

2. Standard Cycle

In a standard cycle, the company launches a new product or modification in existing products every few years and may or may not be able to maintain their leading position in an industry. Therefore strategic alliances are formed to gain market share, and to get a pool of resources for capital projects requiring huge amount of capital, to get benefits of economies of scale, and gain access to complementary resources owned by other firms.

The alliance between Apple Inc and Master Card was occurred to cope-up competition rather than getting into the competition, the second-largest digital payment company "Master Card" decided to get into an alliance with the Apple Inc. In this way, both companies getting the benefit of the alliance. Therefore, Master Card becomes the first company to provide Apple Pay's services, and Apple Pay got the benefit of the Master Card's reputation.

3. Fast Cycle

In a fast cycle, the company is constantly developing new products/services by continuous research and developments and competitive advantages are not protected. Therefore strategic alliances are formed to speed up the development of new goods or services by sharing R&D expenses, streamline market penetration etc.

Luxottica, a leading luxury and sports eyewear company enter into agreement with Google, an internet-based services and products. These two companies formed an alliance to expand their business by combining technology with luxury.

14.11 Advantages of a Strategic Alliance

1. Speed up the entry into a new market:

A strategic alliance is an effective way to enter into a new market or new region or a new product line. Companies can easily reach the customers and can avoid initial hardships of new business by getting into alliance with already existing companies in the market.

2. Enhance sales:

Companies can increase their sales and expand their business by getting into alliance with other companies by learning and obtaining new skills and technology of other company to enhance their own business.

3. Divided fixed costs and resources:

When companies get into an alliance, they work for a common goal by dividing fixed costs and resources required for the business.

4. Innovative products and services:

When two companies from completely two industries come together, they develop innovative products which are beneficial for both companies and help them to enhance their profits.

5. Enhanced distribution channels:

Companies share their resources when they get into business alliance. It allows companies to establish business relationships with new distribution channels and in this way, they can increase the reach ability and availability of their products and services.

6. Easy to get into the international market:

Usually, it is a complex and difficult process for a company to enter into the international market. Strategic alliances between two international companies make it easy for foreign companies to establish their business. With such an alliance, both companies take advantage of and boost their business.

7. Builds the image of the brand:

Strategic alliances with leading companies improve the image of a company in the market. Customers trust the brand if they know about the association of a brand with the brand that they already know.

14.12 Disadvantages of a strategic alliance

1. Poor Management of the business alliances:

In strategic alliances, both companies are responsible for their part and have no responsibility for other’s business activities, which results in poor management over the business alliance.

2. Poor Communication:

There are chances that companies might have poor communication because of the lack of bonding between the involved companies. Poor communication can result in poor decisions and loss of the company's credibility and business in the market.

3. Benefits are unequal:

It is not necessary that companies which are involved in the alliance get equal benefits. Sometimes one company gets more benefits than the other company. There are chances that one business does not hold up their end of the deal honestly, which results in profit loss for other company.

4. The risk to reputation:

There is always a certain percentage of risk of failure of a company and in strategic alliances, the risk of failure increases as the reputation of the business is also influenced by the actions of the alliance company. If they fail in their business dealings in some way, it also impacts the reputation and profit of other company.

5. Barriers in work culture and language:

This type of problem takes place when two companies from different nationalities come together to make a strategic alliances. Different companies have different work culture, and the difference between the work culture of different companies is huge when they are from different nations. This causes conflicts between the employees of the companies and between the management.

In addition to this, language is another barrier that makes strategic alliance ineffective. Due to language barrier employees of alliance companies find it hard to communicate with one another and to convey what they want to convey effectively. Because of this reason, a strategic alliance is opposed by employees.

6. Risks of conflicts:

The risk of conflicts increases when two companies of different work culture come together to work on a project. Most of the times, the companies work hard to sort out all the conflicts that might take place in future and take precautionary actions. But a problem arises when something unexpected happens and cause conflicts among the employees of the companies. This can result in the setbacks in the alliance.

7. Vulnerability:

Getting into a strategic alliance, one company give authority to the partner to get a peek into your internal business procedure. This puts you in a vulnerable situation. For example, if the partner company has access to the data, they can use this information as and when required for their benefits. Therefore, it is important for companies to stay alert and don’t disclose everything to their alliance partner.

8. **Legal issues:**

In the situation of dispute, legal issues can damage the image of a company even when they are not at fault.

14.13 Risks involved in Strategic Alliances

- Differences between both the parties on the processes and operations of the business activities can create problem regarding coordination.
- If there is a condition in the agreement, i.e., the parties need to inform each other of their proprietary information then such a decision requires a high level of trust between both the companies.
- Partners may misrepresent or lie about their competencies or other crucial factors during signing the agreement.
- One party may be able to stand to the commitment of resources and capabilities to the other party involved.
- In the alliance, one of the parties may commit heavily whilst the other may not be that serious about the accomplishment of the common goals and objectives.
- It can be the case that the partners may fail to utilize their complementary resources in an effective manner.

14.14 Mergers and Acquisitions (M&A)

Mergers and acquisitions (M&A) are defined as consolidation of companies. However these terms differs as mergers is defined as the combination of two companies to form one, while **ACQUISITIONS** is defined as one company taking over by the other company. M&A is one of the common phenomena among the corporate world. The major benefit behind M&A is that two separate companies together create more value compared to being on an individual one, i.e., they work on synergy. To achieve the objective of wealth maximization, companies keep eye on different opportunities available through the route of merger or acquisition.

Thus, M&A are transactions in which the ownership of companies, other business organizations, or their operating units are transferred or consolidated with other entities. M&A can allow enterprises to grow or downsize, and change the nature of their business or competitive position. Principle behind any M&A is the group synergy that is 2+2=5. There is always synergy value created when the joining or merger of two companies occurs. The synergy value can be in the form of the high revenues, lowering of expenses or lowering of overall cost of capital.

14.15 Process of Merger and Acquisition (M&A)

The steps in the M&A process are as follows:

1. Business Valuation

This is the first step of M&A and it includes assessment and evaluation of both the present and future market value of the target company. Thorough research is done on the history of the company with regards to capital gains, organizational structure, market share, distribution channel, corporate culture, specific business strengths, and credibility in the market. Many other aspects should be considered to ensure if a proposed company is right or not for a successful merger.

2. Proposal Phase

The proposal phase is a phase in which the company sends a proposal for a merger or an acquisition with complete details of the deal including the strategies, amount, and commitments. Most of the time, this proposal is sent through a non-binding offer document.

3. Exit Planning

When any company decides to sell its operations, it has to undergo the stage of exit planning. The company has to make firm decisions as to when and how to exit in an organized and profitable manner. In the process, the management has to evaluate all financial and other business issues like deciding on a full sale or partial sale along with evaluating various options of reinvestments.

4. Structuring Business Deal

After finalizing the merger and the exit plans, the new entity or the takeover company has to take initiatives for marketing and create innovative strategies to enhance business and its credibility. The entire phase emphasizes on the structuring of the business deal.

5. Stage of Integration

This stage includes both the company coming together with their parameters. It includes the entire process of preparing the document, signing the agreement, and negotiating the deal. It also defines the parameters of the future relationship between the two.

6. Operating the Venture

After signing the agreement and entering into the venture, it is equally important to operate the venture. This operation is attributed to meet the pre-defined objectives of all the companies involved in the process.

14.16 Importance of M&A

1. Offers various tax advantages

Many governments offer tax concessions or reductions when a merger or acquisition is completed. For example Singapore provides substantial tax reduction on account of M&A and is known as one of the best Asian countries where a merger or acquisition could take place in.

2. New possibilities offered by a new market

To decide to enter a new market is a strategic decision by an international company. Even if setting up a branch or subsidiary is a good idea; a merger or acquisition will save time and money spent on starting a business from scratch. For example, to enter into the Dutch market the acquisition or merger of many small companies operating in the Netherlands having own share of loyal customers is the appropriate way. Dutch government also provides the foreign business owner a Dutch residence permit that allows a movement to one of the greatest countries in Europe.

3. Obtaining easier access to a skilled labor force

Sometimes there are legal requirements imposed by national and international regulations to retain existing staff. For example, the UAE is one of the countries which have imposed strict regulations related to international mergers and acquisitions.

4. Diversification of portfolio

By joining forces, the portfolio of the new business can increase even more and gain access to a larger market share, specifically in the case of IT companies in which innovation plays a key role.

5. Buying or merging with another company is usually cheaper

Rather than building production centres, storage, and distribution facilities of own, it's better and least expensive to buy or merge with a company, even if from another country, which already has such facilities.

6. Mergers and acquisitions can mean greater financial power and more influence

Mergers and acquisitions represent growth for both companies involved in the transaction. It may provide more financial power as the revenue generated by pooling the incomes of both businesses and large customer base and more pooled resources.

14.17 Difference between Merger and Acquisition

BASIS FOR COMPARISON	MERGER	ACQUISITION
Meaning	The merger means the combination of two or more than two companies voluntarily to form a new company.	When one company purchases the business of another company, it is known as Acquisition.
Formation of a new company	Occurs	No new company is established
Nature of Decision	The mutual decision of the companies is paid respect which are going through mergers.	Friendly or hostile decision of acquiring and acquired companies.

BASIS FOR COMPARISON	MERGER	ACQUISITION
Minimum number of companies involved	3	2
Purpose	To increase operational efficiency and large pool of resources.	For Instantaneous growth and mitigate competition
Size of Business	Generally, the size of merging companies is more or less same.	The size of the acquiring company will be more than the size of acquired company.
Legal Formalities	More	Less

14.18 Types of Mergers

The following are the types of mergers:

1. **Horizontal mergers**: It refers to two firms operating in same industry or producing ideal products combining together.

For e.g., Acquisition of Times Bank by HDFC Bank, Bank of Madura by ICICI Bank, Nedungadi Bank by Punjab National Bank, etc., are the mergers in same product line. The main objectives of horizontal mergers are to benefit from large level economies of scale, reduce competition, achieve monopoly status and control the market.

2. **Vertical merger**: A vertical merger happens between firm operating at different level of supply-chain. For example: when a firm acquires another firm which produces raw materials used by it. For

example, a tyre manufacturer acquires a rubber manufacturer, a car manufacturer acquires a steel company. Another form of vertical merger happens when a firm acquires another firm which would help it get closer to the customer. For e.g., an FMCG company acquires an advertising company or a retailing outlet or a supplier chain etc.

3. Conglomerate merger: It refers to the combination of two firms operating in industries unrelated to each other. The business of the target company is entirely different from those of the acquiring company. For e.g., a watch manufacturer acquires a cement manufacturer.

4. **Concentric merger**: It refers to combination of two or more firms which are related to each other in terms of customer groups, functions or technology. For example, combination of a computer system manufacturer with a UPS manufacturer.

5. **Forward merger**: In a forward merger, the target merges into the buyer. For example, when ICICI Bank acquired Bank of Madura, Bank of Madura which was the target, merged with the acquirer, ICICI Bank.

6. **Reverse merger**: In this case, the buyer merges into the target and the shareholders of the buyer get stock in the target. This is treated as a stock acquisition by the buyer.

7. **Subsidiary merger**: A subsidiary merger is said to occur when the buyer sets up an acquisition subsidiary which merges into the target.

14.19 The Advantages of Mergers and Acquisitions

1. New Markets

International business expansion through M&A opens vistas and gives access to new markets. Once an organization has merged with another, it instantly gains a new market share that it may not have had before. **Generally, more values are added to the combined entities than either individual company can produce on its own.** M&A enhances level of overall revenue because there aren't costly redundancies. It is also called as the advantage in the form of synergy that is the magic power that allow for increased value efficiencies of the new entity and it takes the shape of returns enrichment and cost savings. Through M&A, companies could save time and resources **which is supposed to be spent on new businesses if new businesses were to be started from scratch.**

Now the merged entity are having larger customer base, so, they could go for experiments for their new products and services in the new market.

2. Benefit of Diversification and expansion of business

Another benefit of the M&A is the diversification as the new merged entity could conduct experiments in the new market and with new customers. They could diversify their businesses and lower the risk of doing new business.

3. Obtaining access to Talented Workforce

There is a great opportunity to retain the talented workforce and induce them in the new entity. The benefits in international M&A are manifold like, increased productivity, advanced educational skills, diverse educational background and more heterogeneous talents.

14.20 The Disadvantages of Mergers and Acquisitions

1. Distress among the Employees

There could be rise in distress among the employees. New management & their different management practices, different organisational structure, different positions, new roles & responsibilities could distress employees.

2. Influence of Culture

Both the international companies prior to the merger and acquisitions have different cultures. The international managers have different way of doing business as their approaches are different like individualism or collectivism, decision making, communication skills, different educational backgrounds etc.

14.21 Check Your Progress

State True or False

(1) Technology transfer is a key factor of globalisation.

(2) Strategic alliance implies to do business by a single company.

(3) Merger is combination of two companies and one old company remain in existence to carry business.

(4) Acquisition means to form a new company with the composition of two companies.

(5) Reverse merger is not a type of merger.

Fill in the Blanks

(6) A carter of companies which do all the business activities in a common way or policy is known as _______________.

(7) Merger is combination of _____________companies and to form a ______________ company.

(8) Acquisition results to remain one old company in existence after acquire _____________.

Objective Type Questions:

(9) Which of the following is an "intellectual property" as per IPR Laws in India?

(a). Original literary work

(b). Industrial Design of Maruti800 car

(c). Trademark of Tata company

(d). All the above

(10) Which of the following is not an intellectual property law?

(a). Copyright Act, 1957

(b). Trademark Act, 1999

(c). Patent Act, 1970

(d). Design Act, 2000

(e). Customs Act, 1962

(11) The merger of J.P. Morgan and Bank One is an example of:

(I) Cross-border merger

(II) Horizontal merger

(III) Conglomerate merger

(IV) Vertical merger

(A) I only

(B) II only

(C) III only

(D) I and III only.

14.22 Summary

Technology Transfer (TT) is the process of conveying the scientific and technological research results to the market place and providing benefits to wider society, along with associated skills and procedures. Technology transfer, also known as tech transfer, is the process by which inventions and innovations are turned into products and commercialized in the market. This is generally done in two ways: through licensing patented intellectual property to corporations, and the creation of start-up companies, which also often license the intellectual property created by owner.

Technology transfer in international business can be categorised in six categories: International Technology Transfer, Regional Technology Transfer, Cross-industry or Cross-sector Technology Transfer, Inter-firm Technology Transfer, Intra-firm Technology Transfer, Pirating or Reverse-Engineering.

International technology transfer has both horizontal and a vertical dimension, each with its own elements.

Broadly the acquisition routes are three: Internal Technology Acquisition, External Technology Acquisition, Hybrid Sources.

The technology transfers require the following decisions to be made at managerial level: Getting Internal Technology First, Internal R&D with Networking, Reverse Engineering, Reverse Brain Drain: Secret or Hidden Acquisition with Internal R&D, Covert Acquisition, Technology Transfer and Absorption, Contract R&D, R&D Strategic Partnership, Licensing, Purchasing, Joint Venture, Acquisition of a Technology Rich Firm, and Strategic Alliances.

Strategic alliances are kind of agreements between two or more independent companies to cooperate in the field of manufacturing, development, or sale of products and services or other business activities.

There are three types of strategic alliances: Joint Venture, Equity Strategic Alliance, and Non-equity Strategic Alliance.

Companies form strategic alliances because of three product life cycles: Slow cycle, Standard cycle, and Fast cycle. Different product life cycles have different need to innovate and continually create new products in an industry.

Advantages of a Strategic Alliance are Speed up the entry into a new market, Enhance sales, Divided fixed costs and resources, Innovative products and services, Enhanced distribution channels, Easy to get into the international market, and Builds the image of the brand.

Disadvantages of a strategic alliance are Poor Management of the business alliances, Poor Communication, Benefits are unequal, The risk to reputation, Barriers in work culture and language, Risks of conflicts, Vulnerability, and Legal issues.

Mergers and acquisitions (M&A) are defined as consolidation of companies. However these terms differs as mergers is defined as the combination of two companies to form one, while **ACQUISITIONS** is defined as one company taking over by the other company

The steps in the M&A process are as follows: Business Valuation, Proposal Phase, Exit Planning, Structuring Business Deal, Stage of Integration, Operating the Venture

Importance of M&A are (i) Offers various tax advantages (ii) New possibilities offered by a new market (iii) Obtaining easier access to a skilled labor force (iv) Diversification of portfolio (v) Buying or merging with another company is usually cheaper (vi) Mergers and acquisitions can mean greater financial power and more influence.

The following are the types of mergers: (i) Horizontal **mergers** (ii) **Vertical merger (iii) Conglomerate merger (iv) Concentric merger** (v) **Forward merger (vi) Reverse merger (vii) Subsidiary merger.**

14.23 Keywords

Technology Transfer

Technology transfer, also known as tech transfer, is the process by which inventions and innovations are turned into products and commercialized in the market.

Strategic Alliances

Strategic alliances are kind of agreements between two or more independent companies to cooperate in the field of manufacturing, development, or sale of products and services or other business activities.

Mergers and Acquisitions

Mergers are defined as the combination of two companies to form one, while **ACQUISITIONS** is defined as one company taking over by the other company.

14.24 Self- Assessment Test

Q.1 What do you understand with the term technology transfer? Describe its implications in different areas.

Q.2 Define strategic alliance. How it actually works? Also elaborate the types of strategic alliance.

Q.3 What is the difference between merger and acquisition? Describe the importance of M&A.

Q.4 Elaborate the different kinds of merger. State the disadvantages of M&A.

Q.5 Describe the process of merger and acquisition.

Q.6 What do you mean by technology transfer? Explain its implication in international business

Q.7 Write a short note on following:

- Joint Venture
- Hybrid Sources

14.25 Answers to Check Your Progress

Answers: Self Assessment

(1) True	(2) False
(3) False	(4) False
(5) True	(6) Strategic
(7) Two, New	(8) Old existing company
(9) D	(10) E
(11) B	

14.26 References / Suggested Readings

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Subject: International Business	
Course code: MBA-205	Author: Dr Vijender Pal Saini
Lesson no. : 15	Vetter: Prof. Pardeep Gupta
Foreign Trade Promotion and Indian Joint Ventures Abroad	

STRUCTURE

15.1 Learning Objectives

Trade promotion, also known as export promotion is an umbrella term including all the economic policies, development interventions by government and private initiatives aimed at improving the trade performance of a country. The objective of this chapter is to get the students acquainted with the knowledge of foreign trade promotion measure and schemes in India.

After reading this chapter, students will be able to:

- Describe the concept of trade promotion
- Explain the concept, process, advantages and disadvantages of joint ventures
- Understand foreign trade promotion measure and schemes in India
- Learn from the Indian joint ventures with foreign companies

15.2 Introduction

Trade promotion, sometimes also known as export promotion is an umbrella term including all the economic policies, development interventions by government and private initiatives aimed at improving the trade performance of a country or group of countries. Improvement in trade performance is mainly targeted by setting objectives and adopting polices to increase exports both in absolute terms as well as relative to imports.

For example, India enjoying surplus of labor, promoting and stimulating policies and schemes to expand the Foreign Trade. The various initiatives and different incentives have been provided to help business firms enhance the competitiveness of their exports.

The Government has also established a number of institutions that provide infrastructural help and also marketing help to organizations doing International business.

15.3 Foreign Trade Promotion Measure and Schemes in India

1. Duty Drawback Scheme

Merchandise that is to be exported is not required for payment of different excise, levy charges and customs duties. On showing verification invoice of export of these merchandise to the concerning authority such charge returns. Such refunds are ‘Duty Drawbacks.’

2. Export Manufacturing under the Bond Scheme

Under this scheme organisations can manufacture merchandise without giving excise duty and different charges. The organizations can benefit this facility after giving an endeavour (i.e. bond) that they are producing commodities for the export purpose.

3. Exemption from Payment of Sales Taxes

Merchandise manufactured solely for exporting is not conditional upon payment of sales tax. Money received from exporting operations has been absolved from giving of Income-tax for a long time now. However this exemption is available only to 100% Export oriented units (EOUs) and units set up in Export Processing Zones / special economic zones (EPZ/SEZ).

4. Advance Licence Scheme

Under this scheme the government permits the supplier the duty-free supply of local and also in addition imported resources required for the manufacturing of export merchandise. The firms which are not regularly exporting can also apply for these licenses against particular export orders.

5. Export Processing Zones

They are industrial areas, generally located close to seaports or air terminals. They intend to provide an internationally competitive duty-free environment for export production at low cost. There are different measures, for example, availability of export fund, export promotion, capital merchandise scheme is in use for foreign trade promotion.

15.4 Organisational Support

The government has set up various institutions in order to facilitate the process of foreign trade. Some of them are as follows:

- **Department of Commerce**

Department of Commerce working under the Ministry of Commerce, Government of India is the most authoritative body responsible for the country's international trade and all jurisdictions are connected with it. The main activities of DoC include shaping of expanding business relations with other nations, state trading, export promotional measures and the development, and regulation of certain export-oriented industries and commodities. The Department of Commerce formulates policies in the sphere of foreign trade. It is also responsible for framing the import and export policy of the country in general.

- **Export Promotion Councils**

Export Promotion Councils are non-profit institutions registered under the Companies Act or the Societies Registration Act. The basic objective of these councils is to develop and promote the export. Each Council is in charge of the promotion of a specific group of projects, products, and services. The council helps in sponsoring the development of export-related industries, market and produce the particular products falling under their jurisdiction in foreign countries.

At present there are 14 EPC's dealing with different commodities namely, Engineering Export Promotion Council of India (EEPC India), Project Exports Promotion Council of India (PEPC), Basic Chemicals, Pharmaceuticals and Cosmetics Export Promotion Council (Chemexcil), Chemicals and Allied Products Export Promotion Council (CAPEXIL), Council for Leather Exports, Sports Goods Export Promotion Council, Gem and Jewellery Export Promotion Council, Shellac Export Promotion Council, Cashew Export Promotion Council of India, The Plastics Export Promotion Council, Export Promotion Council for EOUs & SEZ Units (EPCES), Pharmaceutical Export Promotion Council, Indian Oil Seeds & Produce Export Promotion Council (IOPEPC).

- **Commodity Boards**

Commodity Boards are the boards established by Government of India for the development of manufacturing of traditional merchandise and their exports. These boards works in coordination with the EPCs. There are seven commodity boards in India: Coffee Board, Rubber Board, Tobacco Board, Spice Board, Central Silk Board, Tea Board, and Coir Board.

- **Export Inspection Council**

Export Inspection Council of India is an establishment of the Government of India under Section 3 of the Export Quality Control and Inspection Act 1963. The objective of the council is to ensure the sound development of export trade through quality control and pre-shipment inspection.

The council is a vital body for managing the operations with standard control and pre-shipment inspection of merchandise for export. Exempting a few exceptions, all the merchandise destined for exports must be passed by EIC.

- **Indian Institute of Foreign Trade (IIFT)**

Indian Institute of Foreign Trade is an establishment by the Government of India as an autonomous body in 1963. The prime objective of IIFT is to professionalise the country's foreign trade management and increase exports by developing human resources, analysing and disseminating data and conducting research. IIFT provides services to the students, Government, trade and industry through both sponsored and non-sponsored training, research and consultancy assignments.

- **State Trading Organisation**

The State Trading Corporation of India Ltd. (STC) is an autonomous Government of India company set up in 1956. Its deals in exports, and imports operations primarily. Its objective is to supplement the efforts of private trade and industry in developing exports from the country. It functions under the administrative control of the Ministry of Commerce & Industry, Govt. of India. The main functions of STC are as followings:

- "The Corporation handled canalized exports and imports of large number of items varying from chemicals and drugs to bulk commodities such as edible oils, cement, sugar, newsprint, wheat, urea, etc. thereby ensuring timely availability and equitable distribution of mass consumption items as well as essential raw materials for the industry. Canalisation also helped the nation to benefit from economies of scale and keeping a close watch on the scarce foreign exchange.
- It undertook price support operations to ensure remunerative prices to growers for their crops such as raw jute, shellac, tobacco, rubber and vanilla as and when called upon by the Government to do so.
- As part of its export development effort, STC extend technical, marketing and financial assistance to exporters by arranging import of machinery and raw material for export production

- It helps exporters to set up design centres, providing testing laboratories, taking products of small manufacturers to overseas markets by organising their consortia, participation in exhibitions and trade fairs, etc". (Source: http://www.stclimited.co.in/)

- **Indian Institute of Packaging (IIP)**

The Indian Institute of Packaging is a national apex body institute mutually run by the Ministry of Commerce, Government of India, and the packaging & allied industries. It was established in 1966 with the prime objective of improving the packaging standards in the country. Its head office is located at Mumbai. It is a training-cum-research institute pertaining to packaging and testing.

"The Institute endeavors to improve the standard of packaging needed for the promotion of exports and create infrastructural facilities for overall packaging improvement in India. This is achieved through the Institute's multifarious activities which are today, in line with those of premier packaging institutes the world over. The Institute aims to make India a focal point for contemporary developments in Art, Science, Technology and Engineering, with respect to the field of Packaging. The Institute began in a very humble way, with an office at Mumbai. It has now expanded, with its Head Quarter at Mumbai and Centers located at Delhi, Kolkata, Hyderabad and Chennai". (Source: https://www.iip-in.com/)

- **India Trade Promotion Organisation (ITPO)**

India Trade Promotion Organisation (ITPO) is the premier trade promotion agency of India having headquarter at Pragati Maidan, New Delhi. It is established under the Companies Act 1956 by the Ministry of Commerce, Government of India. ITPO was formed by the merger of the two government agencies namely, Trade Development Authority and Trade Fair Authority of India. Its regional offices are at Bangalore, Chennai, Kolkata and Mumbai. It is proving a broad spectrum of services to trade and industry and also acts as a catalyst for growth of India's trade.

Its basic objective is to support organizations which are engaged in international trade fairs and exhibitions, etc. It also provides support and updated commercial business information. It has an extensive infrastructure as well as marketing and information facilities that are availed by both exporters and importers. ITPO ensures representative participation of trade and industry from different regions of the country in its events in India and abroad. ITPO has 4 international offices in Germany, Japan, UAE and USA.

ITPO is spread over 123 acres of prime land at Pragati Maidan, New Delhi. It offers about 61,290 sq. mtrs. of covered exhibition space in 16 halls, besides 10,000 sq. mtrs. of open display area. The state-of-the-art exhibition halls have enhanced the appeal of Pragati Maidan as the ideal center for an increasing number of fair organisers and business visitors from different parts of the world. ITPO ensures representative participation of trade and industry from different regions of the country in its events in India and abroad. It also provides assistance to State Governments in setting up Regional Trade Promotion Centres (RTPC) in various State's Capital and major cities

The main objectives of ITPO are:

- “To promote external and domestic trade of India in cost effective manner by organizing and participating in international trade fairs in India and abroad; organizing buyer-seller meets and contact promotion programmes abroad; conducting overseas market surveys, exchanging and contact promotion programmes abroad; conducting overseas market surveys, exchanging and coordinating visits of business delegations, and undertake need based research to facilitate trade in specific sectors/markets;
- To support and assist small and medium enterprises to access markets both in India and abroad;
- To disseminate trade information and facilitate E-commerce/trade;
- To develop quality physical infrastructure, services and management so as to enable holding of trade promotion events such as conventions and trade exhibitions of international standard; and
- To enlist the involvement and support of the State Governments, other government trade promotion agencies, trade and industry associations in trade promotion of India’s external and domestic trade”. (https://commerce.gov.in/)

15.5 Joint Venture (JV)

A joint venture (JV) is a commercial enterprise undertaken jointly by two or more parties which otherwise retain their distinct identities. It is a temporary business association in which two or more organisations agree to pool their resources for the purpose of accomplishing a particular task or for profit without forming permanent corproation. This task can be a new project or any other business activity. In a joint venture (JV), each of the participants is responsible for profits, losses, and costs associated with it. The companies go for JV basically to access a new market, to gain scale efficiencies, to get benefits of skills & knowledge, capabilities and to share risk from new projects. However, the venture is its own entity, separate from the participants' other business interests.

When companies go for expanding their business globally to enter new markets, a commonly used strategy is to find a local partner in another country and form an international joint venture. International joint ventures can reduce the required time and expense in developing an international market or supplier base. However, if it is not correctly executed, it can be an expensive failure that can harm the home company's operations and brand image.

15.5.1 Advantages of a Joint Venture

1. New insights & New Markets

Starting a joint venture provides the opportunity to gain new insights, new markets and broader network in international markets.

2. Combining Better Resources

Joint venture is a better way of combining resources and expertise of two companies. Joint venture provide organisation with access to better resources, new knowledge, specialized as well as expert staff and technology. All the equipment and capital that the firm needed can be used in the foreign markets.

3. It is temporary, not the firm's permanent business

A joint venture is only a temporary arrangement between two or more companies. They need not to commit for long times.

4. All parties share the risks and costs

A joint venture gives opportunity to the international companies to share the risk and cost associated with the project.

5. Firms can exit a joint venture as per specifications

The two companies come, share and work together on projects and departs as and when required. No ownership is diluted. In the timeline of divestiture and consolidation, a joint venture offers a creative way for companies to escape non-core businesses.

6. Probably Successful

The chances of success become higher in joint venture because renowned brands joined hands for a particular project. Thus the firm also get benefit of creditability and improved brand image.

7. Improved Economies of Scale

Bigger companies enjoy economies of scale. Economies of Scale refer to the cost advantage experienced by a firm when it increases its level of output. The greater the quantity of output produced, the lower the per-unit fixed cost. The benefit of economies of scale is gained by the combined entities in the joint venture

15.5.2 Disadvantages of a Joint Venture

1. No equal involvement of all parties to contract

Different multinational companies are having different strategies to be implemented. Every company is having its own objectives. Both the companies of the joint venture have come together to fulfil certain common objectives. In this scenario, an equal share of profits and revenue may be possible, but it is not possible for both the companies to work together to share the same involvement and responsibilities in different countries.

2. Great imbalance

Because different companies are involved together in a joint venture, there is a great possibility of imbalance of expertise, assets, and investment. This can have a negative impact on the effectiveness of the joint venture.

3. Cultural Conflict

Differences in the socio-cultural environment of the two countries are the biggest disadvantage of the joint venture. Every company has a different style of working with distinct culture. A cultural conflict in management styles may also occur which also result in poor co-operation and integration during work. Manager and employees with different beliefs, tastes, languages, attitudes, behaviour and preferences may get into conflict which further reduces the efficiency and effectiveness.

4. Limited outside opportunities

Sometime joint venture contracts restrict the outside activities of participant companies during working on a venture project. This may be disadvantageous for their individual interest in business.

5. Thorough Research Work & Analysis Required

The success of a joint venture largely depends on thorough research and analysis of the project and resources required in international markets. Thus, it not guarantees profits always.

6. Lack of Clear Communication

As a joint venture involves different companies from different countries with different strategies, objectives, goals and beliefs, thus, there remains lack of communication as a barrier between partners.

15.5.3 Process of International Joint Venture

The International Joint Venture Contract involves the agreement between two companies located in different countries to conduct a particular work or project. A separate set up, commonly in the form of a third company is established with the intention of jointly establishing an activity with its own objectives: research, marketing and distribution, manufacturing, etc. Drafting International Joint Ventures Contracts requires a five-step methodology in order to negotiate them successfully:

Step 1. Joint Venture mentality

The primary goal of Step 1 is to establish a partnership mentality. Both parties must make a conscious effort to create an environment of trust; one in which they are transparent about their high-level aspirations, specific goals and concerns.

Step 2. Co-create a shared vision and objectives

To keep expectations aligned in a complex and changing environment, both parties –not just the one with greater power – need to explain their vision and goals for the relationship.

Step 3. Adopt guiding principles

Value-eroding friction and shading occur because one or both parties feel unfairly treated. This risk is highest when there are many unknowns about what will occur after the Joint Venture contract is signed.

In Step 3, parties commit to six guiding principles that contractually prohibit opportunistic tit-for-tar moves.

The six principles are: reciprocity, autonomy, honesty, loyalty, equity and integrity. They form the basis for all International Joint Venture Contracts using vested methodology and provide a framework for resolving potential misalignments when unforeseen circumstances occur.

Step 4. Align expectations and interests

Having set the foundation for the relationship in the first three steps, parties hammer out the terms of the Joint Venture Contract. It is crucial that all terms and conditions of the formal relationship contract are aligned with the guiding principles. With the right mindset, the development of the Joint Venture Contract becomes a joint problem-solving exercise rather than an adversarial contest.

Step 5. Stay aligned

In this final step, contracting parties go beyond crafting the terms of the agreement and establish governance mechanisms that are formally embedded in the contract.

This process should be part of the drafting of International Joint Ventures Contracts whose objective is to govern highly complex relationships that demand collaboration and demand.

15.6 Indian Joint Ventures with Foreign Companies

A Joint Venture is a way of putting together or combining the resources and expertise of two companies that are otherwise unrelated. A foreign company as defined in Section 2(42) of the Companies Act 1956, is any company or body corporate incorporated outside India which has a place of business in India, whether by itself or through an agent, physically or through an electronic mode and conducts any business activity in India in any other manner.

For an Indian company to venture partnership with a foreign company, a Joint Venture Agreement is to be entered into by both the parties. Such an agreement also contains terms relating to confidentiality and non-disclosure of information before the commencement of negotiation of the Joint Venture. The following criteria should be met for the successful establishment of an International Joint Venture:

In areas like telecommunication, drugs and pharmaceuticals, advertising and hotel and tourism, investment up to 74 percent in a Joint Venture without the approval of RBI.

More than 74 percent of the total equity in any Joint Venture company, if that's the case, permission of the Foreign Investment Promotion Board (FIPB) or the Secretariat of Industrial Approvals (SIA) must be obtained.

Ranked as the world's 6th largest economy by Gross Domestic Product (GDP) in 2017, India also enjoys the world's 3rd highest purchasing power parity as per World Bank statistics. While this country is home to subsidiaries of various MNCs, another substantial number of companies are now envisaging upfront in setting up of Joint Ventures in India.

India has witnessed several successful cases of International Joint Ventures flourishing since the post-independence. Examples of joint venture in India are as following:

Hindustan Aeronautics Limited

Hindustan Aeronautics Limited (HAL) is an Indian state-owned aerospace and defence company having vision to become a significant global player in the aerospace industry. Its headquarter is in Bangalore (Bengaluru), India. It is governed under the management of the Indian Ministry of Defence. Its mission is to achieve self reliance in design, development, manufacture, upgrade and maintenance of aerospace equipment diversifying into related areas and managing the business in a climate of growing professional competence to achieve world class performance standards for global competitiveness and growth in exports.

Major international customers of HAL are Airbus Industries, France; Boeing, USA; GE Aviation, USA; Rolls Royce Plc, UK; RAC MIG, Russia; Royal Malaysian Air Force, Malaysia; Rosoboron Export, Russia; Royal Thai Air Force, Thailand; Ecuadorian Air Force, Ecuador; Hamilton Sundstrand, USA; Honeywell International, USA; Vietnam Air Force, Vietnam; Nepal Army, Nepal; Israel Aircraft Industries, Israel; Turbomeca, France; Coast Guard, Mauritius; Ruag, Germany Moog Inc. USA; Royal Air Force, Oman. (Source: https://hal-india.co.in/)

Joint Venture & Shareholding Pattern	**Purpose of Joint Venture**	**Name & Registered Address of the Joint Venture Company**
HAL - 49% BAe Systems PLC, UK -	Design, Develop & Market Computer Software,	**BAeHAL Software Ltd.,** HAL Main Factory,

40%. BAe HAL Employees Welfare Trust, India -11%	Firmware Programs and provide software solutions & service to the customers.	Near Departure Lounge, Old Airport Road, Bengaluru-560 017 Karnataka, India
<u>Indian Firms</u> HAL : 48% ICICI Bank : 5% **<u>Russian Firms</u>** RAC MiG : 31 % Ryazan :10 % Aviazapchast :6 %	Provide product support / spares for Russian / erstwhile Soviet Union origin fleet of aircraft by sourcing through its Russian partners.	**Indo Russian Aviation Ltd.,** 15/1, Cubbon Road Bengaluru- 560001 Karnataka, India
HAL :50% Safran Aircraft Engines, France: 50%	Centre of Excellence for production of Precision Aero engine components and assemblies as an Export Oriented Unit (EOU).	**<u>Safran HAL Aircraft Engines Pvt. Ltd.,</u>** 140/1, Hoody – White field Road, Whitefield Industrial Area, Bengaluru – 560 086 Karnataka, India
HAL : 50% CAE Inc., Canada : 50%	Provide military and civil helicopter pilot training services in India	**<u>HATSOFF Helicopter Training Pvt Ltd.</u>** Survey Nos. 3 & 4 , Opposite ARDC Main Gate, HAL, Vibhuthipura, Marathahalli Post Bengaluru-560 037 Karnataka – India
HAL :50% Edgewood Ventures, LLC,	Development and manufacture of high	**HAL Edgewood Technologies Pvt. Ltd.,**

USA : 26% Edgewoodtechnologies Pvt. Ltd, India : 24%	technology miniature electronic modules and avionics systems for aerospace applications.	3rd Floor, Old ADB Building, HAL Main Factory, Near Departure Lounge, Old Airport Road, Bengaluru-560 017 Karnataka, India
HAL :50% Rolls-Royce Overseas Holdings Ltd., UK : 50%	Manufacturing of Civil aerospace components viz. Shrouds & Cones for Rolls Royce.	**International Aerospace Manufacturing Pvt. Ltd.,** Survey No 3 Kempapura Village, Varthur Hobli, Bengaluru East Taluk, Bengaluru – 560 037 Karnataka, India

(Source: https://hal-india.co.in/)

TATA SIA Airlines Limited

Vistara is a joint venture of Tata Sons Private Limited and Singapore Airlines Limited (SIA), wherein Tata Sons holds 51% stake in partnership and Singapore Airlines owns 49% stake. The company is registered as TATA SIA Airlines Limited. The common goal of the joint venture is to redefine air travel in India to provide Indian travellers a seamless and personalized flying experience that blends Tata's and SIA's service excellence and legendary hospitality.

Vistara launched international operations to Singapore from August 2019. The airline had a daily operation each from Delhi and Mumbai to Singapore. Vistara had earlier planned to start flights to Colombo from July but stalled its plans after the Easter Sunday blasts in the Sri Lankan capital. It obtained government approval to launch international flights. Apart from Singapore and Colombo, it has approvals for operations to Bangkok and Dubai. (https://economictimes.indiatimes.com/)

BrahMos Aerospace

India’s entry into supersonic missile club was led by BrahMos Aerospace, a JV between India’s Defense Research and Development Organization (DRDO) and Russia’s NOP Mashinostoryenia. The word Brahmos was given using names of Brahmaputra river of India and Russian capital city, Moscow.

Another example of joint venture in India is-Russia and India came together to make the world’s fastest cruise missile that can fly at a supersonic speed of Mach-2.8 to Mach-3.

Through a Joint Venture in India, companies, local or foreign combine their respective expertise to provide better products and services pan-world. The number of successful Joint Ventures in India is escalating every day coupled with a few unsuccessful ones like Tata DoCoMo (a joint venture between Tata Teleservices and Japan’s NT DoCoMo) which could not make enough profits. Nevertheless, Joint Ventures in India aid in consolidating the position of the nation as an economic power and industrial major. Joint venture companies in India have flourished a lot.

15.7 Check Your Progress

Objective Type Questions:

(1) Indian Institute of Foreign Trade (IIFT) is registered under which of the following Act?

(A) Societies Registration Act

(B) Companies Act

(C) Banking Regulation Act

(D) RBI Act.

(2) In which year the Indian Institute of Foreign Trade (IIFT) was established?

(A) 1962

(B) 1963

(C) 1964

(D)1965

(3) Which of the following is not an advantage of exporting?

(A) Easier way to enter in international markets.

(B) Comparatively lower risk

(C) Limited presence in foreign markets

(D) Less investment requires

(4) When two or more firms come together to create a new business entity that is legally separate and distinct from its parents, it is known as _________________ .

(A) Contract Manufacturing

(B) Joint Ventures

(C) Franchising

(D) Licensing

(5) ITPO has _____________offices in India?

(A) 3

(B) 4

(C) 5

(D) 6

(6) Which of the following is not a commodity board in India?

(A) Tobacco Board

(B) Spice Board,

(C) Cotton Board

(D) Rubber Board

State whether the following statements are True or False:

(7) Export Processing Zones are industrial areas, generally located close to seaports or air terminals.

(8) India Trade Promotion Organisation (ITPO) is established under the India Trade Act, 1956.

(9) The main purpose of STC is to promote trade, primarily export trade among different trading partners of the globe.

(10) ITPO was formed by the merger of the two government agencies namely, Trade Development Authority and Export Promotion Councils.

(11) The concept of EPZ has replaced the concept of SEZ in the country.

15.8 Summary

Trade promotion, sometimes also known as export promotion is an umbrella term including all the economic policies, development interventions by government and private initiatives aimed at improving the trade performance of a country or group of countries.

Foreign Trade Promotion Measure and Schemes in India are 1. Duty Drawback Scheme 2. Export Manufacturing under the Bond Scheme 3. Exemption from Payment of Sales Taxes 4. Advance Licence Scheme and 5. Export Processing Zones.

Organisational Supports provided by Indian government are Department of Commerce, Export Promotion Councils, Commodity Boards, Export Inspection Council, Indian Institute of Foreign Trade (IIFT), State Trading Organisation, Indian Institute of Packaging (IIP), India Trade Promotion Organisation.

A joint venture (JV) is a business arrangement in which two or more companies agree to pool their resources for the purpose of accomplishing a particular task

Advantages of a Joint Venture are 1. New insights and expertise 2. Better resources 3. It is temporary, not the firm's permanent business 4. All parties share the risks and costs 5. Firms can exit a joint venture as per specifications 6. Probably successful 7. Build relationships and networks and 8. Eradicates the risk of discrimination.

Disadvantages of a Joint Venture No equal involvement of all parties to contract, Great imbalance, Clash of cultures, Limited outside opportunities, A lot of research and planning are necessary, and Lack of clear communication.

Drafting International Joint Ventures Contracts requires a five-step methodology in order to negotiate them successfully: **Step 1. Joint Venture mentality, Step 2. Co-create a shared vision and**

objectives, Step 3. Adopt guiding principles, Step 4. Align expectations and interests, Step 5. Stay aligned

15.9 Keywords

Joint Venture

A joint venture (JV) is a business arrangement in which two or more companies agree to pool their resources for the purpose of accomplishing a particular task in which each of the participants is responsible for profits, losses, and costs associated with it.

Economies of Scale

Economies of Scale refer to the cost advantage experienced by a firm when it increases its level of output. The greater the quantity of output produced, the lower the per-unit fixed cost.

15.10 Self- Assessment Test

Q.1 Elaborate the objectives of the Indian Trade Promotion Organization (ITPO).

Q.2 What do you mean by Joint Venture? Explain its advantages and disadvantages.

Q.3 Write down the different measures adopted to promote international trade.

Q.4 Elaborate the organisational support to facilitate the process of foreign trade.

Q.5 "Indian Government supports and promotes the exports". Discuss this statement and explain various incentives and promotions schemes for exports by Indian government.

Q.6 Discuss the role of foreign trade in the growth of Indian Economy.

Q.7 What points should be kept in mind while entering into a joint venture? Also explain the process of Joint Venture.

Q.8 Take an example of joint venture between an Indian company and a foreign company and state its advantages for India.

15.11 Answers to Check Your Progress

(1) A	(2) B
(3) C	(4) B

(5) C (6) C

(7) True (8) False

(9) True (10) False

(11) False

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These two articles will give the glimpses of Indian Joint Ventures upto 1984:

K. Balakrishnan, MNCs from LDCs: The case of Indian joint ventures abroad, Vol. 7, No. 2, April-June, 1982.

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Multilateral Regulation of Trade and Investment: IMF, World Bank, WTO, UNCTAD and Regional Economic Cooperation

STRUCTURE

16.1 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

16.2 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.

16.3 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.

16.4 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 green house 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.

16.5 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.

16.5.1 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/)

16.5.2 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 recommendations.

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.

16.5.3 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.

16.5.4 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."

16.5.5 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.

16.5.6 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.

16.6 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.

16.6.1 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.

16.6.3 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.

16.7 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.

16.7.1 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.

16.7.2 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.

16.7.3 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.

16.7.4 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.

16.7.5 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.

16.8 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.

16.8.1 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.

16.8.2 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.

16.9 Major Areas of Regional Economic Integration and Cooperation

16.9.1 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.

16.9.2 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.

16.10 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.

16.11 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.**

16.12 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.

16.13 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?

16.14 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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