SASURIE COLLEGE OF ENGINEERING

DEPARTMENT OF MASTER OF BUSINESS ADMINISTRATION

REGULATION 2021

II YEAR – III SEMESTER

BA4302

INTERNATIONAL BUSINESS

INTERNATIONAL BUSINESS

BA4302

UNIT I AN OVERVIEW OF INTERNATIONAL BUSINESS

Definition and drivers of International Business-Changing Environment of International BusinessCountry attractiveness- Trends in Globalization- Effect and Benefitof Globalization-International Institution: UNCTAD Basic Principles and Major Achievements, Role of IMF, Features of IBRD, Role and Advantage of WTO.

UNIT II THEORIES OF INTERNATIONAL TRADE AND INVESTMENT

Theories of International Trade:Mercantilism, Absolute Advantage Theory, Comparative Cost Theory, Hecksher-Ohlin Theory-Theories of Foreign Direct Investment : Product Life Cycle, Eclectic, Market Power, Internationalisation-Instruments of Trade Policy : Voluntary Export Restraints, Administrative Policy, Anti-dumping Policy, Balance of Payment.

UNIT III GLOBAL ENTRY

Strategic compulsions-– Strategic options – Global portfolio management- Global entry strategy, different forms of international business, advantages - Organizational issues of international business –Organizational structures – Controlling of international business, approaches to control – Performance of global business, performance evaluation system.

UNIT IV PRODUCTION, MARKETING, FINANCIALS OF GLOBAL

BUSINESS Global production:
Location, scale of operations- cost of production- Standardization Vs DifferentiationMake or Buy decisions- globalsupply chain issues- Quality considerations. Globalization of markets: Marketing strategy-Challenges in product development- pricingproduction and channel management. Foreign Exchange Determination Systems: Basic Concepts-types of Exchange Rate Regimes- Factors Affecting Exchange Rates.

UNIT V HUMAN RESOURCE MANAGEMENT IN INTERNATIONAL BUSINESS

Selection of expatriatemanagers- Managing across cultures -Training and developmentCompensation-Disadvantages of international business – Conflict in international business- Sources and types of conflict – Conflict resolutions – Negotiation –Ethical issues in international business – Ethical decision-making.

UNIT-1

International Business

International business may be defined simply as business transactions that take place across national borders. Nearly all business enterprises, large and small, are inspired to carry on business across the globe. This may include, purchase of raw materials, from foreign suppliers, assembling products from components made in several countries or selling products or services to customers in other nations.

Other definitions:

1) IB field is concerned with the issues facing international companies and governments in dealing with all types of cross border transactions.
2) IB involves all business transactions that involve two or more countries.
3) IB consists of transactions that are devised and carried out across borders to satisfy the objectives of individuals and organizations.
4) IB consists of those activities private and public enterprises that involve the movement across national boundaries of goods and services, resources, knowledge or skills.**Nature of**

Multinational Enterprise:

A MNE has a worldwide approach to foreign markets and production and an integrated global philosophy encompassing both domestic and international markets.

International Business

1. Accurate Information
2. Information not only accurate but should be timely
3. The size of the international business should be large
4. Market segmentation based on geographic segmentation
5. International markets have more potential than domestic markets

Scope of International Business

1. International Marketing
2. International Finance and Investments
3. Global HR
4. Foreign Exchange

Need for International Business

1. To achieve higher rate of profits
2. Expanding the production capacity beyond the demand of the domestic country
3. Severe competition in the home country
4. Limited home market
5. Political conditions
6. Availability of technology and managerial competence
7. Cost of manpower, transportation
8. Nearness to raw material
9. Liberalization, Privatization and Globalization (LPG)
10. To increase market share
11. Increase in cross border business is due to falling trade barriers (WTO), decreasing costs in telecommunications and transportation; and freer capital markets

Reasons for Recent International Business Growth

1. Expansion of technology
2. Business is becoming more global because
   - Transportation is quicker
   - Communications enable control from afar
   - Transportation and communications costs are more conducive for international operations
3. Liberalization of cross-border movements
4. Lower Governmental barriers to the movement of goods, services, and resources enable Companies to take better advantage of international opportunities

Problems in International Business

1. Political factors
2. High foreign investments and high cost
3. Exchange instability
4. Entry requirements
5. Tariffs, quota etc.
6. Corruption and bureaucracy
7. Technological policy

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 and domestic markets. The environment can be classified in terms of domestic, foreign, and international spheres of impact.

1. The domestic environment – is familiar to managers and consists of those uncontrollable external forces that affect the firm in its home market.

2. The foreign environment - can be taken as those factors which operate in those other countries within which the MNC operates.

3. The international environment - is conceived as the interaction between domestic and foreign factors and indeed they cover a wide spectrum of forces

The forces:

- Political environment
- Legal environment
- Cultural environment
- Technological environment
- Economic environment.

1. Political Environment

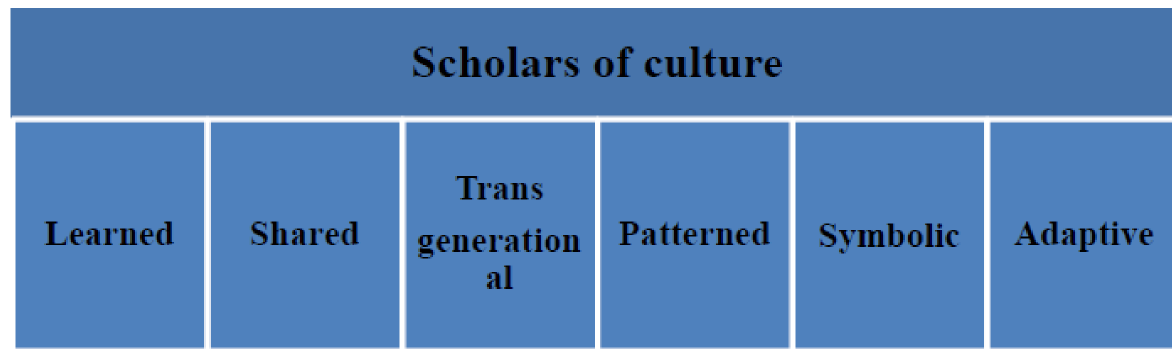
A political system is basically the system of politics and government in a country. It governs a complete set of rules, regulations, institutions, and attitudes. A main differentiator of political systems is each system's philosophy on the rights of the individual and the group as well as the role of government. Each political system's philosophy impacts the policies that govern the local economy and business environment. It refers to the influence of the system of government and judiciary in a nation on international business. The type and structure of government prevailing in a country decides, promotes, fosters, encourages, shelters, directs, and controls the business of that country. A political system is stable, honest, efficient, and dynamic and which ensures political participation to the people and assures personal security to the citizens, is a primary

Arbitration: is the preferred method for resolving international commercial disputes. The usual arbitration procedure is for the parties involved to select a disinterested and informed party or parties as referee to determine the merits of the case and make a judgment that both parties agree to honor.

Litigation: a wise course of action would be to seek a settlement other than by suing.

3. Cultural environment:

According to Elbert W Steward and James A Glynn "Culture consists the thought and behavioral patterns that members of a society learn through language and other forms of symbolic interaction – their customs, habits, beliefs and values, the common viewpoints that bind them together as a social entity**.**



Levels of culture:

1. National culture:
It is dominant culture within the political boundaries of a country.

2. Business culture:
It also provides the guides for everyday business interactions.

3. Occupational and organizational cultures:
It's sister term is corporate culture refers to the philosophies, ideologies, values, assumptions, beliefs, expectations, attitudes and norms that knit an organization together and are shared by its employees

4. Mechanistic and organic cultures:
It exhibits the values of bureaucracy and feudalism.

5. Authoritarian and participative cultures:
Power is concentrated on the leader and obedience to orders and disciplines are stressed. Participative cultures tend to emerge where most organizational members are professionals or see themselves as equals.

6. Dominant and sub-cultures:
Dominant culture, normally referred to as the organizational culture reflects core values that are shared by the majority of the employees. By contrast, sub-cultures are found in departments, divisions and geographical areas and reflect the common problems or experiences of employees who reside in these areas.

7. Strong, Weak and Unhealthy cultures:
A **Strong culture** will have a significant influence on employee behavior manifesting in reduced turnover, lower absenteeism, increased cohesiveness, and positive attitudes.

A **Weak culture** is characterized by the presence of several sub-cultures, sharing of few values and behavioral norms by employees and existence of few sacred traditions.

One **Unhealthy culture** is a politicized internal environment that allows influential manager to operate autonomous "fiefdoms" and resist needed change.

Elements of culture

1. Language
2. Customs and manners
3. Attitudes
4. Aesthetics
5. Religion
6. Education
7. Supernatural beliefs

Implications for international business

Multiculturalism:

Managing multiculturalism is essential for every international firm.

1. Spread cross-cultural literacy
2. Compatibility between strategy and culture
3. Culture and competitive advantage
4. Managing diversity.

Changing Preferences

- A major socio-cultural factor influencing businesses and business decisions is changing consumer preferences.
- What was popular and fashionable 20 years ago may not be popular today or 10 years down the road.
- Different styles and priorities can undermine long successful products and services. For example, a clothing company must constantly be aware of changing preferences when creating new products or it will quickly become outdated.

Demographics

- Changes in demographics are also a significant factor in the business world.
- As populations age, for example, markets for popular music and fashions may shrink while markets for luxury goods and health products may increase.
- Additionally, changes in the proportion of genders and different racial, religious and ethnic groups within a society may also have a significant impact on the way a company does business.

Advertising Techniques

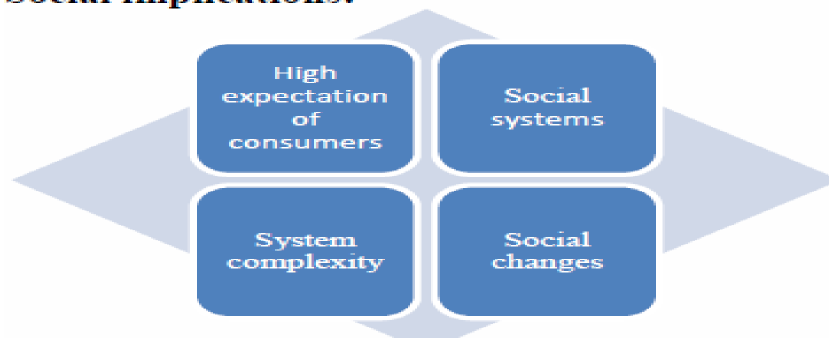
- Advertising is perhaps the area of business most closely in touch with socio-cultural changes.
- Advertising often seeks to be hip and trendsetting, and to do this, advertising agencies and departments cannot lose track of the pulse of the societies in which they engage in business.
- Changes in morals, values and fashions must all be considered when creating outward facing advertising.

- TECHNOLOGICAL ENVIRONMENT

IMPACT OF TECHNOLOGY:

Technology		
Social implications	Economic implications	Plant level changes

Social implications:



Economic implications:

- Increased productivity
- Need to spend on R&D
- Jobs become intellectual
- Problems of techno-structure
- Increased regulation and stiff opposition
- Rise and decline of products and organizations
- Boundaries redefined
- Training of scientists and engineers.

Plant level changes:

- Organization structure
- Resistance to change
- Fear of risk
- E-commerce
- Patenting
- Transportation
- Markets
- Technology transfers
- Production

Operational sequences for technology transfer

- Arrangements for sales & licensing
- Provision of know-how & technical expertise
- Provision of detailed engineering designs & installation
- Purchases and leases of technology elements

- Technical cooperation agreements

4. ECONOMIC ENVIRONMENT:

It can help international managers, to predict how trends and events might affect performance of foreign business.

I) Classification on the basis of income:

1. **Developing countries:** share a set of common and well – defined goals. Ex: India, China.
2. **Developed countries:** Those are highly industrialized, highly efficient. Ex: Canada, Japan, Australia, US.

II) Countries classified by economic system:

1. **Market economy:** production of goods and services is not planned by individuals
2. **Command economy:** decisions relating to all economic activities – what to produce, how to produce.
3. **Mixed economy:** it includes both. Ex: India.

III) Classification of countries by region:

1. East Asia and Pacific
2. Europe and central Asia
3. Latin America and the Caribbean
4. Middle east and North Africa
5. South Asia
6. Sub-Saharan Africa
7. High income countries

IV) Economic scenario:

1. Rates of growth
2. Inflation
3. Savings and investment
4. Fiscal stability
5. Balance of payments
6. Financial system

V) Economic policies:

1. Industrial policy
2. Monetary policy
3. Fiscal policy
4. Trade policy

Government System

- Businesses must often contend with different **governmental systems.**
- Examples include democracies, authoritarian governments, and monarchies.
- Some governments are easier to work with than others.
- Democracies, for example, are answerable to their citizens and the rule of law. Authoritarian regimes are usually answerable to no one, including the law. It is less risky to conduct business in democracies and constitutional monarchies (a monarch with a constitution that protects the public and subjects the monarch to the rule of law) than in countries with authoritarian regimes.

c) **Trade Agreements**

- Countries often enter into trade agreements to help facilitate trade between them.
- If your country has entered into a trade agreement with another country, conducting business in that country will usually be easier and less risky because the trade agreement will provide some predictability and protection.
- One great advantage, for example, is that your products will be subjected to fewer trade barriers that serve as obstacles to exporting your products into the country.

d) **Formal Trade Barriers**

- A **trade barrier** is simply anything that makes it harder for a company to export products to a foreign country.
- Formal trade barriers are enacted by governments for the purpose of restrictingimports to protect a country's domestic industries.
- Formal trade barriers include **tariffs**, which are taxes on imports that helps make domestic products more competitive, and **product quotas** that limits the number of products imported into the country.

e) **Informal Trade Barriers**

- Governments may impose regulations that aren't primarily promulgated as barriersto trade but have the same effect.
- Examples can include specific product standards and health and safety standards that businesses will be required to meet before the products can be sold.

Economic Development:

- Economic development differs widely among the countries and regions of the world. Countries can be categorized as either developing or developed.
- Developing countries are referred to as less developed countries (LDCs).
- The criterion traditionally used to classify countries as developing is per capita income, which is the income generated by the nation's production of goods and services divided by total population.
- The developing countries have low per capita incomes.
- LDCs generally are located in Asia, Africa, and South America. Developed countries are generally located in North America , Europe and Japan.
- Most international business firms are headquartered in the wealthier, economically advanced countries,
- However, smart companies are investing heavily in Asia, Eastern Europe and Latin America.
- For example the number of Internet users and the rate of e-commerce in Latin America is rapidly growing. Computer companies have launched on line stores for Latin American customers to buy computers over the Internet.
- American Online sees Latin America as crucial to expanding its global presence, even though Universe Online International (UOL) based in Brazil got a tremendous head start over AOL.

Infrastructure:

- A country's physical facilities that support economic activities make up its infrastructure which includes transportation facilities such as airports highways, and railroads, energy producing facilities such as utilities and power plants and communication facilities such as telephone lines and radio stations.
- Companies operating in LDCs must contend with lower levels of technology and perplexing logistical distribution and communication problems.
- Undeveloped infrastructures represent opportunities for some firms, such as United Technologies Corporation based in Hartford, Connecticut whose business include jet engines air conditioning and heating systems and elevators.

Trade

- Trade barriers are government-induced restrictions on international trade. Man-made trade barriers come in several forms, including:

  - o Tariffs
  - o Non-tariff barriers to trade
  - o Import licenses
  - o Export licenses o Import quotas o Subsidies
  - o Voluntary Export Restraints o Local content requirements o Embargo
  - o Currency devaluation

Trade restriction

- Most trade barriers work on the same principle–the imposition of some sort of cost on trade that raises the price of the traded products. If two or more nations repeatedly use trade barriers against each other, then a trade war results.
- Economists generally agree that trade barriers are detrimental and decrease overall economic efficiency. This can be explained by the theory of comparative advantage.
- In theory, free trade involves the removal of all such barriers, except perhaps those considered necessary for health or national security.
- In practice, however, even those countries promoting free trade heavily subsidizecertain industries, such as agriculture and steel.
- Trade barriers are often criticized for the effect they have on the developing world.
- Because rich-country players set trade policies, goods, such as agricultural products that developing countries are best at producing, face high barriers.
- Trade barriers, such as taxes on food imports or subsidies for farmers in developed economies, lead to overproduction and dumping on world markets, thus lowering prices and hurting poor-country farmers.
- Tariffs also tend to be anti-poor, with low rates for raw commodities and high rates for labor-intensive processed goods.
- The Commitment to Development Index measures the effect that rich country trade policies actually have on the developing world.

- An export subsidy can also be used to give an advantage to a domestic producer overa foreign producer.
- Export subsidies tend to have a particularly strong negative effect because in addition to distorting resource allocation, they reduce the economy's terms of trade.
- In contrast to tariffs, export subsidies lead to an over allocation of theeconomy's resources to the production of tradeable goods.

Internal Environment

- In addition to a company's interactions with the market and its customers, socio-cultural factors also impact a company's internal decision-making process.
- For example, changing gender roles and increasing emphasis on family life have led to increased respect for maternity and even paternity leave with organizations.
- Additionally, attitudes towards racial discrimination and sexual harassment have changed drastically over the years as a result of socio-cultural change.

Religion and Custom

- Religion and custom are two of the most important factors impacting a business.
- Every organization has to adapt itself to the prevalent customs and traditions in a region.
- A uniform business policy cannot be implemented throughout the world, as allowances need to be made for the religious sensibilities of the local population.
- Let us understand the concept in detail with the help of an example.
  - McDonald's, one of the largest restaurant chains in the world, started its India operations in 1996.
  - Although McDonald's had been in business for roughly 40 years, during which it had expanded to different parts of the world, its foray into the Indian sector was met with skepticism.
  - The prime reason why many people didn't give McDonald's a chance in India was because most of the McDonald's restaurants around the world served beef in their burgers.
  - India, with its Hindu majority population, considers cow as sacred, and vegetarianism is taken so seriously that many vegetarians avoid sitting with someone having a non-vegetarian meal.
  - The marketing heads at McDonald's were also aware of the vast diversity in Indian food habits, and they had to come up with a menu that would appeal to such a large number of people.
  - To succeed in a country where frugality was an inherent characteristic, McDonald's also had to work towards keeping the price of its products under check, without compromising on the hygiene and quality factors.
  - To succeed in such a behemoth and diverse market, McDonald's had to pay attention to all these socio-cultural factors.

Change in Preferences

- One of the most important socio-cultural trends which has an impact on a business is the constantly changing preferences of customers.
- A business may build a brand name for itself and model its core strategies in a certain manner, but if it fails to recognize and adapt to the changing preferences of the customers, it is doomed to fail.
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  - The launch of iPhone, and its subsequent critical and commercial acclaim, was a clear indicator to all handset manufacturers that customers expected quality experience while browsing the internet, listening to songs, watching videos, etc.

iPhone's unprecedented sales, despite the fact that it came with a higher contract cost, was a testimony to the fact that the customers were appreciative of innovation and technology, and didn't mind paying extra to get the best thing in the market.

Change in Demographics

- Demographics is another socio-cultural factor that has an impact on the fortunes ofa business.
- The number of people living in a region, their ethnicity, age, gender, race, sex, etc. are important factors to consider for any business organization.
- An understanding of the demographics of the customer base can provide a business with invaluable pointers towards launching new products, pricing, marketing strategies,etc.
  - The following example will illustrate how demographics lead to a change in strategy.
    - o Harley Davidson, the iconic US-based motorcycle manufacturer, has established itself as one of the premier bike makers in the world.
    - o Most of the customer base of Harley Davidson comprises Baby Boomers, over the age of 35. After the World War II ended, America emerged as one of the most powerful nations of the world.
    - o The period after the war was filled with optimism and exhilaration.
    - o The Baby Boomer generation grew up in a period marked with added emphasis on individuality and adventure.
    - o Motorcycling had emerged as an alternate lifestyle, with most motorcyclists preferring the heavy, cruiser bikes of Harley Davidson.

Marketing

- Socio-cultural factors play a major role in the marketing strategy of a business.
- In fact, the whole idea of marketing is to connect with the existing customers, and to reach out to potential customers.
- The way a society is composed, and the manner in which it views itself culturally, plays an important role in the development of a robust marketing strategy.
- The marketing strategies vary from one country to another, and the factors that influence the strategy are literacy levels of the population, its core beliefs, its sensitivities, willingness to change, etc.

- In the following example, we will take a look at how Nestlé had to change its marketing policy to prevent itself from being in the center of a controversy.
  - o Nestlé, one of the largest food-processing brands in the world, was involved in a controversy in the 1970s, when it was accused of causing deaths and malnutrition in infants in sub-Saharan Africa.
  - o The center of the controversy was Nestlé's breastfeeding substitute - a baby milk powder.
  - o The substitute was marketed aggressively all around the world, but in several African countries, where literacy levels were low, people failed to realize that the product was aimed to act as a substitute for those children, whose mothers were unable to breastfeed them.

CHALLENGES FOR GLOBAL BUSINESS

Too often business owners jump when they see opportunities abroad without first taking the time to conduct research and train their employees for the challenges they may face. Here are some of the top challenges and risks that small businesses face.

- **Inexperienced management team**.

  The management team of small businesses may not have experience with international businesses.

  Having experience with conducting business globally is critical for businesses to move into the international market with the lowest amount of surprises, mistakes, and expenses.

  The management team should be provided with appropriate training beforehand. Another option is to hire internal or external experts to guide decision making.

- **No local marketing contacts or partners.**

  Having connections in the foreign country is a valuable asset to pushing the product out faster and obtaining a quicker ROI.

  If the business does not have any contacts or partners, it should start working on networking and possibly hiring a local marketing firm.

- **Foreign country's laws and regulations**.

  Each country has its own set of laws and regulations when it comes to importing goods, taxes, and even selling online.

  Obtain legal advice from someone experienced in business law for that country and conduct your own research to see which laws and regulations will affect your business.

  However, finding information online does not replace legal advice from a qualified lawyer.

- **Inadequate infrastructure within the foreign country.**

  Some countries do not have adequate infrastructure for transporting goods.

  Find out which obstacles exist and what should be done to overcome them or what adjustments should be made.

- **Cultural and language barriers**.

  Researching the local culture and speaking the same language is not enough to communicate efficiently.

  When two people are speaking the same sentence, the underlying meaning may not be the same.

  Find out how the locals conduct business and how their culture affects their decision making and communication.

- **Corruption amongst foreign officials**.

  Corruption is more prevalent than what most small business owners are prepared for.

  Conduct research into the foreign country and find out how business is truly conducted.

  If possible, avoid countries where corruption is prevalent to save on future headaches and possible losses.

- **Company is not flexible**.

  After entering into the foreign market the business may have to adapt further to the local market.

  Small businesses that are not flexible or refuse to make alternations will lose out on customers and potential revenue.

  The business should be prepared to make changes after entrance and have the structure in place for quick decision making and implementations.

- **Tariffs and quotas**.

  Countries add taxes or restrictions to particular products coming into their country in order to give their own businesses a higher advantage.

  Unsuspecting small business owners unaware of these tariffs and quotas can end up at a loss instead of profiting.
- **Pricing is not optimized for the country.**

  Small business owners that price its products the same in foreign country as in the United States is either overcharging or undercharging customers.

  For instance, in countries with a lower GDP, consumers have less money to spend on purchases so lower price points should be set to attract more buyers.

- **Does not provide after sales services**.

  Customer support should be available in the language of each country and be conveniently accessible.

  Customers should not have to pay long distance charges in order to receive assistance.

  Small business owners should ensure that they are providing adequate customer service to all their customers.

  They can outsource this to a customer call center within the country.

COUNTRY ATTRACTIVENESS:

It is a multidisciplinary concept at the crossroads of development economics, financial economics, comparative law and political science: it aims at tracking and contrasting the relative appeal of different territories and jurisdictions competing for "scarce" investment inflows, by scoring them quantitatively and qualitatively across ad hoc series of variables such as GDP growth, tax rates, capital repatriation.

There are multiple factors determining host country attractiveness in the eyes of large foreign direct institutional investors, notably pension funds and sovereign wealth funds. Research conducted by the World Pensions Council (WPC) suggests that perceived legal/political stability over time and medium-term economic growth dynamics constitute the two main determinants. Some development economists believe that a sizeable part of Western Europe has now fallen behind the most dynamic amongst Asia's emerging nations, notably because the latter adopted policies more propitious to long-term investments:

Country Attractiveness Assessment

A country attractiveness assessment is based on two dimensions

- Market and industry opportunities
- Country risks (many organizations publish country assessment results based on various economic/political/social factors)

Country attractiveness analysis

1. Market opportunities

Market opportunities assessment measures the potential demand in the country for a firm's products or services based on:

- Market size
- Growth
- Quality of demand.

2. Industry opportunities

- Industry opportunities assessment determines profitability potential of a company's presence in a country given the following factors:

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Resource availability (Porter's diamond framework)

Framework for country market and industry attractiveness assessment MARKET – How important is the demand in this country? + Growth? + Size? + Customer quality

- Resources
- Skilled personnel
- Raw materials
- Components
- Labor
- Technology
- Innovation
- Quality of infrastructure supporting services
- Location

Country attractiveness analysis

- **Political risks**

Political risks are probable disruptions owing to internal or external events or regulations resulting from political action of governments or societal crisis and unrest.

- **Economic risks**

Economic risks expose business performance to the extent that the economic business drivers can vary and therefore put profitability at stake.

- **Competitive risks**

Competitive risks are related to non-economic distortion of the competitive context owing to cartels and networks as well as corrupt practices. The competitive battlefield is not even and investors who base their competitive advantage on product quality and economics are at disadvantage.

- **Operational risks.**

Operational risks are those that directly affect the bottom line, either because government regulations and bureaucracies add costly taxation or constraints to foreign investors or because the infrastructure is not reliable.

Framework for country risk analysis

Political risks operational risks competitive risks economic risks

- Shareholders exposure
- Assets destruction (war, riots)
- Assets spoliation (expropriation)
- Assets immobility (transfer, freeze)
- Operational Exposure
- Market disruption
- Labor unrest
- Racketing
- Supply shortages
- Employees Exposure
- Kidnapping
- Gangsterism
- Harassment
- Variability
- Inflation

Cost of inputs

- Exchange rates
- Business logics
- Corruption
- Cartels

 Networks

Infrastructure - Power, Telecommunication, Transport - Supplier Country Risk Analysis

o Regulations
o Nationalistic preferences
o Constraints on local capital, local content, local employment

GLOBALIZATION

Globalization of the economy means reduction of import duties, removal of Non-Tariff Barriers on trade such as Exchange control, import licensing etc., allowing FDI and FPI,
allowing companies to raise capital abroad and grow beyond national boundaries and encourage exports. Both Foreign Trade and Foreign investment volume have grown rapidly over the last few years.

The IMF defines globalizations 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 widespread diffusion of technology.

Benefits of Globalization

1. **Free Trade**

- Free trade is a way for countries to exchange goods and resources.
- This means countries can specialize in producing goods where they have a comparative advantage (this means they can produce goods at a lower opportunity cost).
- When countries specialize there will be several gains from trade
  - o Lower prices for consumers
  - p Greater choice of goods
  - o Bigger export markets for domestic manufacturers
  - o Economies of scale through being able to specialise in certain goods

2. **Free Movement of Labor**

- Increased labor migration gives advantages to both workers and recipient countries.
- If a country experiences high unemployment, there are increased opportunities to look for work elsewhere.
- This process of labor migration also helps reduce geographical inequality.
- This has been quite effective in the EU, with many Eastern European workers migrating west.
- Also, it helps countries with labor shortages fill important posts.
- For example, the UK needed to recruit nurses from the far east to fill shortages.

3. **Increased Economies of Scale.**

- Production is increasingly specialized.
- Globalization enables goods to be produced in different parts of the world.
- This greater specialization enables lower average costs and lower prices for consumers.

4. **Greater Competition**

- Domestic monopolies used to be protected by lack of competition.
- However, globalization means that firms face greater competition from foreign firms.

Factors Causing Globalization of Business

1. **Technological Advancement**

- Technological advancement at almost every level, from widespread Internet access to standardization of transport containers and rapid global transportation, serves as a key driver of globalization.

- Standardization of manufacturing processes allows businesses to harness the economies of scale that make it feasible to serve a global-sized market, and reliable, worldwide transportation provides the necessary element to build a supply chain to serve that market.
- The 24/7 nature of the Internet gives consumers easy access to products from across the world and, in turn, drives a need for globalization in marketing.

2. Global Communication

- Global communication, aided in large part by online communication channels, such as social media, aid in the transmission not only of ideas, but of social norms and wants.
- In essence, global communication leads to more homogenized tastes in everything from tablet computers to music.
- This trend toward global-level interest in products, regardless of origin point, calls for marketing that deals with brands from a global perspective, rather than a local or even national level.
- Marketers must craft imagery and messages that transcend cultural particulars and reflect universally appealing core ideas.

3. Capital Mobility

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- Capital now moves across national borders with comparative ease, which makes it easier for companies to secure financing from a variety of sources.
- This ability to secure funding from abroad, should domestic sources prove unwilling, can facilitate domestic growth and foreign expansion.
- In order to secure foreign funding, a business's marketing team must prove capable of demonstrating that, for example, a foreign market exists for the business's products, and that it knows how to address both domestic and foreign markets to capture share in both.

4. Considerations

- Globalization presents a conundrum for small business owners.
- On the one hand, small businesses often find themselves competing with and marketing in competition with better funded global brands.
- On the other hand, these same businesses have access to a worldwide consumer base that can prove a substantial source of income.
- Choosing between offering service to a worldwide consumer base or focusing on capturing local and regional business means weighing a number of factors, including logistics, expense, and the difficulty inherent in developing global-friendly marketing materials.

- Developing countries continue to drive the global recovery, but their output growth is also expected to moderate to 6.0 per cent during 2011-2012, down from 7.0 per cent in 2010, because of the slowdown in the advanced countries and phasing out of stimulus measures.
- Developing Asia, led by China and India, continues to show the strongest growth performance, but some moderation (to around 7 per cent) is expected in 2011 and 2012.

5. High unemployment is the Achilles heel for the recovery

- The Uruguay Round of trade negotiations (1986-94) was the real watershed for global trade.
- Here, a large package of measures was agreed, which freed up trade in both goods and in services.
- As a result, the volume of world trade rose by 50% just in the 6 years following the conclusion of the Uruguay Round.
- Equally important is the number of countries taking part in free trade negotiations.
- In 1948, when the GATT treaty became effective, there were only 23 Contracting Parties to the agreement.
- Just over 60 years later, there are now 153 member states of the WTO who all enjoy the benefits of free trade based on the principle of comparative advantage.
- Accordingly, between 1948 and 2008, trade rose from only 5% to a massive >25% of world GDP.
- This means countries are becoming more and more reliant upon each other for their export earnings, income and employment.
- This exposes them to the international trade multiplier, where domestic business cycles become vulnerable to changes in the level of economic activity in the rest of the world.

6. Transport Costs

- Improvements in containerization have drastically lowered freight charges.
- For example, over the last 25 years, sea transport unit costs have fallen by over 70%, while air-freight costs have fallen by 3-4% year-on-year.
- The result has been a boost in trade flows, as transport costs are now less likelyto cancel out the gains from comparative advantage.
- However the rise in sea and air transport has also caused great concern over the negative externalities of global trade.
- Indeed recent estimates that CO_2 emissions will rise by >70% by 2020 have ledto calls for green taxes on shipping transport.
- If these go ahead, they will partially offset the falls in transport costs, hence the process of globalization will be dampened to some extent.

7. Growth of the Internet

- The growth of the internet has increased e-commerce, enabling firms of all sizes to compete more easily in global markets.
- Essentially, the internet acts as a 24-hour shop front allowing consumers all over the world to buy products online and around the clock, from whoever happens to be offering the best deal.

other for the sale and provision of goods and services.

Problems in Globalization:

- Global competition and imports keep a lid on prices, so inflation is less likely to derail economic growth.
- An open economy spurs innovation with fresh ideas from abroad.
- Export jobs often pay more than other jobs.
- Unfettered capital flows give the US access to foreign investment and keep interest rates

low.

- Millions of Americans have lost jobs due to imports or production shifts abroad. Most find new jobs that pay less
- Millions of others fear losing their jobs, especially at those companies operating under competitive pressure.
- Workers face pay cut demands from employers, which often threaten to export jobs.
- Service and white collar jobs are increasingly vulnerable to operations moving offshore
- U S employees can lose their comparative advantage when companies build advanced factories in low-wage countries, making them as productive as those at home.

Globalization of Indian Business:

- India's economic integration with the rest of the world was very limited because of the restrictive economic policies followed until 1991. Indian firms confined themselves, by and large, to the home market. Foreign investment by Indian firms was very insignificant.
- With the new economic policy ushered in 1991, there has, however, been a change. Globalization has in fact become a buzz-word with Indian firms now, and many are
- expanding their overseas business by different strategies.

Factors Favoring Globalization:

- Human Resources
- Wide Base
- Growing Entrepreneurship
- Growing Domestic Market
- Niche Markets
- Expanding Markets
- Trans-nationalization of World Economy
- NRIs
- Economic Liberalization• Competition

Disadvantages of globalization

1. **Globalization may encourage more offshoring instead of less.**
   With fewer restrictions in place at the national level, some businesses may use offshoring to their advantage. Even if they kept jobs local, the threat of sending jobs to a different, cheaper region overseas could be used to justify lower wages at home. The end result of an effort to remove borders would be an increase in wages in the developing world, but a decrease in developed countries. Many households could see their standard of living go down if consumable price decreases don't occur simultaneously.

2. **Globalization benefits the wealthy more than the poor.**
   Value-added taxes above 25% exist in some nations. Tariffs above 70% exist for some

most significant rewards. Those with money to invest would see their bank accounts continue to rise. At the same time, households living paycheck-to-paycheck would struggle to access what they require, suppressing their ability to pursue a better job.

3. **Globalization would encourage disease transfer.**
   The outcome of the Columbian Exchange was profound at the time. Over 90% of some population centers died because of their exposure to smallpox, chickenpox, and other diseases that the Europeans were somewhat immune to at the time. The Europeans brought back syphilis and other diseases as well. If global travel restricts eased, then issues with malaria and tropical disease could spread to portions of the world where exposures are minimal. Tuberculosis, certain influenza strains, and other communicable disease could produce outbreaks at epidemic levels.
4. **Globalization could reduce social safety net programs.**
   Most nations today offer those in extreme poverty access to safety net programs for basic supplies. Even in the United States, programs like WIC and SNAP offer food and care access to those who cannot afford it on their own for whatever reason. When we reduce or eliminate borders, there would be a likely shift in social programs to benefit those earning less than $2 per day while ignoring the needs of those at home. Households living in poverty in the U.S. or United Kingdom fit into a different definition when compared to global poverty.
5. **Globalization would create a new system of politics.**
   We've already received a sneak peek of what a global society would be like from a political perspective. The individuals and organizations who spend the most to lobby politicians would receive the best chance of having their needs met first. We've seen billions spent in
   U.S. elections lately to influence legislation and policy to become favorable toward specific outcomes. This issue would translate to a global economy, where only the richest and most influential would influence laws which would impact everyone.
6. **Globalization would not prevent resource consumption.**
   The goal of globalization is to equalize patterns of consumption for populations around the world. Even though there would be movement toward doing so, there is no getting around the fact that the wealthiest nations will still consume the most resources. The 20 richest countries in the world today consume almost 90% of the planet's resources each year. The United States constitutes 5% of the global population right now, but it consumes 24% of the world's energy as a country.
7. **Globalization would make it easier for people to cheat.**
   The statistics of consumption (especially food) show us already that those who are in power take the majority of resources away from the general population. Americans eat almost 200 billion more calories per day as a nation than they require, which means 80 million people are hungry needlessly because of these consumption habits. About 200,000 tons of edible food is disposed of daily in the United States. By the age of 75, the average person in the
   U.S. creates 52 tons of garbage.
8. **Globalization doesn't fix a lack of skills.**
   The future of employment involves programming, robotics, and artificial intelligence. Workers who adapt to automation with their skillset are the most likely to find employment in the coming generations. Jobs which require repetitive functions will be the first to go away, which are the employment opportunities often found in the developing world. With no meaningful skills to a globalized economy, there could be a higher unemployment rate if border restrictions reduce because only those in the developed world would be trained for the new economy.
9. **Globalization changes how humans would identify themselves.**
   Humans are global citizens in some ways already. We all share the same planet, after all, so we are united with that common ground. If we lose borders, however, we also lose a

already seen how this works when Texas came into the U.S. after being an independent nation. Some Texans label themselves as such first, but many see themselves as an American before being a Texan.

10. **Globalization would negatively impact the environment.**
    We've already seen what free trade does to the environment. Greenhouse gas emissions rose in 2018 despite efforts to curtail them. Micro-plastics invaded our oceans, creating negative impacts on marine life. The waters of our planet are slowly acidifying, creating economic and health impacts every day. Over 200,000 Americans die each year because of pollution exposure. If caps are taken off of what is not permitted through globalization, then this issue will continue growing worse.

INTERNATIONAL AGENCIES

UNCTAD:

The Bretton Woods System had the guiding principles of free trade and non-discrimination in international trade. It resulted in the emergence of institutions like the IMF and GATT. After a decade of euphoria and expectations from these institutions, the LDC's realised that these institutions were meant primarily for advanced countries through fostering freer and expanded trade among them and to extend just temporary assistance to them to adjust their payments imbalances within the regime of fixed exchange rates.

Organisation and Functions of UNCTAD:

The U.N. General Assembly declared in December 1961 that 1960's would be the development decade. It indicated the recognition of the need for adopting measures to bridge up the trade and technological gaps between the rich and the poor countries of the world. In July 1962, the developing countries at their Cairo Conference adopted "Cairo Declaration" and called upon the United Nations to convene an international conference on trade and development.The United Nations Economic and Social Council agreed to convene such a conference and passed a resolution to this effect on August 3, 1962. The United Nations General Assembly endorsed it in its resolution of December 8, 1962. It was on the recommendation of the United Nations Economic Council in July 1963 for convening a conference on trade and development that the United Nations Conference on Trade and Development (UNCTAD) was set up in 1963 as a permanent organ of the UN General Assembly.

It also defined the functions, activities and membership of the UNCTAD. All these developments resulted in the convening of the United Nations Conference on Trade and Development in Geneva from March to June 1964.

Organisation:

The UNCTAD has been set up as a permanent organ of the UN General Assembly. It has its own structure of subsidiary bodies and a full time Secretariat. It has instituted a Trade and Development Board and takes policy decisions when the conference is not in session. It is composed of 55 members, elected by the conference from among its members on the basis of equitable geographical distribution. The meeting of the Board takes place twice a year.

The Trade and Development Board is assisted in its functions by four subsidiary committees.

These include:

(i) The committee on commodities,
(ii) The committee on manufactures,
(iii)The committee on shipping; and
(iv)The committee on invisible items and financing related to trade.

The meeting of these committees generally takes place once a year but the special session of committees can be convened to deal with the matters of urgent nature. All the members of the United Nations are eligible for the membership of the UNCTAD.

Functions:

The essential purpose of instituting UNCTAD was to promote accelerated development of the less developed regions of the world by dealing properly with the problem of slow expansion of exports, persistently increasing BOP deficits, burden of external debts etc. confronting the LDC's.

Functions of the UNCTAD:

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

(ii) To formulate the principles and policies concerning international trade and related problems of economic development.

(iii) To make proposals for putting the said principles and policies into effect and to adopt measures that may be relevant to this end.

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

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

Basic Principles:

(i) Sovereign right of each member country to dispose of freely its natural resources in the interest of its development, well-being of its population and furtherance of its trade with other countries.

(ii) International economic and trade relations shall be based on such principles as respect for sovereign equality of states, self-determination and non-interference in the internal affairs of the others.

(iii) No discrimination among member countries on account of differences in socio-economic system and independent pursuit of economic and other policies.

(iv) Extension of preferential concessions.

(v) Greater market access for the products of the less developed countries.

(vi) Reduction in tariff and non-tariff restrictions on trade.

(vii) Unconstrained flow of international aid.

International Monetary Fund (IMF) was established at a United Nations Monetary and Financial Conference, also known as Bretton Woods Conference, on 22 July 1944 as an organ under the UN System. The IMF headquarters is located in Washington D.C., U.S.A.
IMF is responsible for promoting international monetary cooperation; facilitating the expansion and balanced growth of international trade; promoting exchange stability; assisting in the establishment of a multilateral system of payments; and providing resources available to members experiencing balance of payments difficulties. The International Monetary Fund aims to reducing global poverty, encouraging international trade, and promoting financial stability and economic growth.

The IMF has three main functions: **overseeing economic development, lending, and capacity development.**

Surveillance : The IMF closely monitors each member country's economic and financial developments and holds a policy dialogue with a member country on a regular basis (also known as Article IV Consultation), usually once each year, to assess its economic conditions with a view to providing policy recommendations. The IMF also reviews global and regional developments and outlook based on information from individual consultations. The IMF publishes such assessment on the multilateral surveillance through the World Economic Outlook and the Global Financial Stability Report on a semi-annual basis.

IMF loans are primarily financed by its member countries through payments of quotas. Thus, the IMF's lending capacity is mainly determined by the total amount of quotas. Nevertheless, if necessary, the IMF may borrow from a number of its financially strongest member countries

Technical Assistance : The IMF provides technical assistance to help member countries strengthen their capacity to design and implement effective policies in four areas, namely, 1) monetary and financial policies, 2) fiscal policy and management, 3) statistics and 4) economic and financial legislation. In addition to technical assistance, the IMF also offers training courses and seminars to member countries at the IMF Institute in Washington D.C., and other regional training institutes (Austria, Brazil, China, India, Singapore, Tunisia and United Arab Emirates).

IBRD

The International Bank for Reconstruction and Development (IBRD), commonly referred to as the World Bank, is an international financial institution whose purposes include assisting the development of its member nation's territories, promoting and supplementing private foreign investment and promoting long-range balance growth in international trade. The World Bank was established in December 1945 at the United Nations Monetary and Financial Conference in Bretton Woods, New Hampshire. It opened for business in June 1946 and helped in the reconstruction of nations devastated by World War II. Since 1960s the World Bank has shifted its focus from the advanced industrialized nations to developing third-world countries.

Organization and Structure:

The organization of the bank consists of the Board of Governors, the Board of Executive Directors and the Advisory Committee, the Loan Committee and the president and other staff members. All the powers of the bank are vested in the Board of Governors which is the supreme policy making body of the bank.

The board consists of one Governor and one Alternative Governor appointed for five years by each member country. Each Governor has the voting power which is related to the financial contribution of the Government which he represents.

Objectives:

1. To provide long-run capital to member countries for economic reconstruction and development.
2. To induce long-run capital investment for assuring Balance of Payments (BoP) equilibrium and balanced development of international trade.
3. To provide guarantee for loans granted to small and large units and other projects of member countries.
4. To ensure the implementation of development projects so as to bring about a smooth transference from a war-time to peace economy.
5. To promote capital investment in member countries by the following ways;

(a) To provide guarantee on private loans or capital investment.

(b) If private capital is not available even after providing guarantee, then IBRD provides loans for productive activities on considerate conditions.

Functions:

World Bank is playing main role of providing loans for development works to member countries, especially to underdeveloped countries. The World Bank provides long-term loans for various development projects of 5 to 20 years duration.

1. World Bank provides various technical services to the member countries. For this purpose, the Bank has established "The Economic Development Institute" and a Staff College in Washington.
2. Bank can grant loans to a member country up to 20% of its share in the paid-up capital.

3. The quantities of loans, interest rate and terms and conditions are determined by the Bank itself.
4. Generally, Bank grants loans for a particular project duly submitted to the Bank by the member country.
5. The debtor nation has to repay either in reserve currencies or in the currency in which the loan was sanctioned.
6. Bank also provides loan to private investors belonging to member countries on its own guarantee, but for this loan private investors have to seek prior permission from those counties where this amount will be collected.

GATT (General Agreement On Tariffs And Trade)

GATT is a multilateral trade agreement with overseas and it has been labeled the locomotive that powers international conference. Created in January 1948 is intended to achieve a broad, multilateral and free worldwide system of trading.

Formation:

- A treaty created following the conclusion of World War II. The General Agreement on Tariffs and Trade (GATT) was implemented to further regulate world trade to aide in the economic recovery following the war. GATT's main objective was to reduce the barriers of international trade through the reduction of tariffs, quotas and subsidies.
- Formed in 1947 and signed into international law on January 1, 1948, GATT remained one of the focal features of international trade agreements until it was replaced by the creation of the World Trade Organization on January 1, 1995.
- The role of GATT in integrating developing countries into an open multilateral trading system is also of major consequence.
- The increasing participation of developing countries in the GATT trading system and the pragmatic support provided to them through the flexible application of certain rules helped developing countries to both expand and diversify their trade.

Basic principles of GATT:

- Member countries will consult each other concerning trade problems.
- It provides a framework for negotiation and embodies results of negotiations in a legal environment.
- Trade should conduct on a non-discriminatory basis.

Objectives of GATT:

1. To provide equal opportunities to all countries in international market for trading purpose.
2. To increase the effective demand.
3. To provide amicable solution to the disputes related to international trade.
4. To ensure a better living standards in the world as a whole.

WTO

WTO (World Trade Organization) is an international organization. It enacts the rules governing trade between countries of goods, services, agricultural and industrial goods, and intellectual property. Its aim is to reduce the obstacles to free trade in order to help producers of goods and services, exporters and importers to carry out their activities.

WTO officially commenced on 1 January 1995 under the Marrakesh Agreement, signed by 123 nations on 15 April 1994, replacing the General Agreement on Tariffs and Trade(GATT) . WTO currently has 164 members, of which 117 are developing countries or separate customs

territories. WTO activities are supported by a Secretariat of some 700 staff, led by the WTO Director-General. The Secretariat is located in Geneva, Switzerland, and has an annual budget of approximately CHF 200 million ($180 million, €130 million). The three official languages of the WTO are English, French and Spanish.

Objectives of WTO

- To improve the standard of living of people in the member countries.
- To ensure full employment and broad increase in effective demand.
- To enlarge production and trade of goods.
- To increase the trade of services.
- To ensure optimum utilization of world resources.
- To protect the environment.
- To accept the concept of sustainable development.

Functions of WTO:

- To implement rules and provisions related to trade policy review mechanism.
- To provide a platform to member countries to decide future strategies related to trade and tariff.
- To provide facilities for implementation, administration and operation of multilateral and bilateral agreements of the world trade.
- To administer the rules and processes related to dispute settlement.
- To ensure the optimum use of world resources.
- To assist international organizations such as, IMF and IBRD for establishing coherencein Universal Economic Policy determination.

Organization structure of the WTO

1. Ministerial conference
2. General council,
3. Councils,
4. Committees and Management bodies

1. Ministerial conference:

It is the authority to make decisions on all matters relating to multilateral trade agreements. It is the top decision making body of the WTO. It meets at least once in every two years. There have been seven ministerial conferences.

I) **First ministerial conference** – held in Singapore 1996, primary purpose to initiate an international effort among global trading nations.

II) **Second ministerial conference** - was held in Geneva in Switzerland.

III) **Third ministerial conference** - was held in Seattle in Washington

IV) **Fourth ministerial conference** - was held in Doha in Persian Gulf Nation of Qatar.

V) **Fifth ministerial conference** - was held in Cancun, Mexico.

VI) **Sixth ministerial conference** - held in Hong Kong.

VII) **Seventh ministerial conference -** held in Geneva, Switzerland

2. General council:

The general council has other forms like dispute settlement body and trade policy reviews body.

3. Councils:

I. Council for trade in goods

There are 11 committees under the jurisdiction of the Goods Council each with a specific task. All members of the WTO participate in the committees. The Textiles Monitoring Body is separate from the other committees but still under the jurisdiction of Goods Council. The body has its own chairman and only 10 members. The body also has

groups relating to textiles.

II. Council for trade in services

The Council for Trade in Services operates under the guidance of the General Council and is responsible for overseeing the functioning of the General Agreement on Trade in Services (GATS). It is open to all WTO members, and can create subsidiary bodies as Required.

III. Council for trade related aspects of intellectual property rights.

Information on intellectual property in the WTO, news and official records of the activities of the TRIPS Council, and details of the WTO's work with other international organizations in the field.

4. Committee and management bodies:

The general council delegates powers, responsibilities and authorities to these bodies.

I. Committee on trade and development

II. Committee on balance of balance of payments

III. Committee on budget, finance and administration. **Trade Negotiations Committee**

The Trade Negotiations Committee (TNC) is the committee that deals with the current trade talks round. The chair is WTO's director-general. As of June 2012 the committee was tasked with the Doha Development Round.

The Service Council has three subsidiary bodies: financial services, domestic regulations, GATS rules and specific commitments. The council has several different committees, working groups, and working parties. There are committees on the following: Trade and Environment;

Secretariat

- The WTO secretariat, based in Geneva, has around 600 staff and is headed by a Director- General.
- Its annual budget is roughly 160 million Swiss Francs.
- It does not have branch offices outside Geneva.
- Since decisions are taken by the members themselves, the secretariat does not have the decision making the role that other international bureaucracies are given.
- The secretariat s main duties to supply technical support for the various councils and committees and the ministerial conferences, to provide technical assistance for developing countries, to analyze world trade and to explain WTO affairs to the public and media.
- The secretariat also provides some forms of legal assistance in the dispute settlement process and advises governments wishing to become members of the WTO.

GATT-WTO: Comparison

Major Issues Agreements

- **Agreement on Agriculture:**

The Agreement on Agriculture includes specific and binding commitments made by WTO Member governments in the three areas of market access, domestic support and export subsidization for strengthening GATT disciplines and improving agricultural trade. These commitments were implemented over a six-year period.

- **Agreement on the Application of Sanitary and Phytosanitary (SPS) Measures**:

This agreement establishes multilateral frameworks for the planning, adoption and implementation of sanitary and phytosanitary measures to prevent such measures from being used for arbitrary or unjustifiable discrimination or for camouflaged restraint on international trade and to minimize their adverse effects on trade.

- **Agreement on Textiles and Clothing:**

Textile trade was governed by the Multi-Fiber Arrangement (MFA) since 1974. However, the GATT principles had been undermined by import protection policies, etc. The agreement provides that textile trade should be deregulated by gradually integrating it into GATT disciplines over a 10-year transition period.

- **Agreement on Technical Barriers to Trade (TBT)**

Standards and conformity assessment systems, such as industrial standards and safety/environment regulations, may become trade barriers if they are excessive or abused. This agreement aims to prevent such systems from becoming unnecessary trade barriers by securing their transparency and harmonization with international standards.

- **Agreement on Trade-Related Investment Measures (TRIMs):**

In relation to cross-border investment, countries receiving foreign investment may take various measures, including imposing requirements, conditions and restrictions (investment measures) on investing corporations. In the Uruguay Round, negotiations were initially conducted with an eye toward expanding disciplines governing investment measures. However, the Agreement on Trade-Related Measures, which was the result of the negotiations, banned only those investment measures inconsistent with the provisions of ArticleIII (principle of national treatment) and Article XI (general elimination of quantitative restrictions) which have direct adverse effects on trade in goods. As examples, the Agreement cited local content requirements (which require that certain components be domestically manufactured) and trade balancing requirements.

- **Anti-Dumping Agreement**

This agreement aims to tighten and codify disciplines for calculating dumping margins and conducting dumping investigations, etc. in order to prevent anti-dumping measures from being abused or misused to protect domestic industries.

- **Agreement on Pre-shipment Inspection (PSI):**

This agreement aims to secure transparency of PSI and to provide a mechanism for the solution of disputes between PSI agencies and exporters.

- **Agreement on Rules of Origin:**

This agreement provides a program for the harmonization of rules of origin for application to all non-preferential commercial policy instruments. It also establishes disciplines that must be observed in instituting or operating rules and provides for dispute settlement procedures and creates the rules of origin committee. However, details on the harmonization of rules of origin are left for future negotiations.

- **General Agreement on Trade in Services (GATS)**

This agreement provides general obligations regarding trade in services, such as most- favored-nation treatment and transparency. In addition, it enumerates 155 service sectors and stipulates that a member country cannot maintain or introduce, in the service sectors for which it has made commitments, market access restriction measures and discriminatory measures that are severer than those on the commitment table.

- **Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)**

This agreement stipulates most-favored-nation treatment and national treatment for intellectual properties, such as copyright, trademarks, geographical indications, industrial designs, patents, IC layout designs and undisclosed information. In addition, it requires Member countries to maintain high levels of intellectual property protection and to administer a system of enforcement of such rights. It also stipulates procedures for the settlement of disputes related to the agreement.

- **Agreement on Government Procurement;**

This agreement requires national treatment and non-discriminatory treatment in the area of government procurement (purchase or lease of goods and services by governments) and calls for fair and transparent procurement procedures. It also stipulates complaint and dispute settlement procedures. The new Government Procurement Agreement is based on the Agreement of 1979 (an agreement from the Tokyo Round), but expands its scope. The new Agreement covers the procurement of services (in addition to goods) and the procurement by sub-central government entities and government-related agencies.

- **Agreement on Subsidies and Countervailing Measures:**

This agreement aims to clarify definitions of subsidies, strengthen disciplines by subsidy type (extension of the range of prohibited subsidies, etc.), and to strengthen and clarify procedures for adopting countervailing tariff.

- **Agreement on Import Licensing Procedures:**

In order to prevent import licensing procedures of different countries from becoming unnecessary trade barriers, this agreement aims to simplify administrative procedures and ensure their fair operation.

- **Agreement on Rules of Origin:**

This agreement provides a program for the harmonization of rules of origin for application to all non-preferential commercial policy instruments. It also establishes disciplines that must be observed in instituting or operating rules and provides for dispute settlement procedures and creates the rules of origin committee. However,

Advantages and disadvantages of WTO

- **Lower prices for consumers**. Removing tariffs enables us to buy cheaper imports
- **Free trade encourages greater competitiveness**. Through free trade, firms face a higher incentive to cut costs. For example, a domestic monopoly may now face competition from foreign firms.

- **The law of comparative advantage** states that free trade will enable an increase in economic welfare. This is because countries can specialise in producing goods where they have a lower opportunity cost.
- **Economies of scale**. By encouraging free trade, firms can specialise and produce a higher quantity. This enables more economies of scale, this is important for industries with high fixed costs, such as car and aeroplane manufacture. In new trade theory, it is this specialisation and exploitation of economies of scale that is most important factor in improving economic welfare.

Disadvantages of WTO

- However, the WTO has often been criticised for trade rules which are still unfavourable towards developing countries. Many developed countries went through a period of tariff protection; this enabled them to protect new, emerging domestic industries. Ha Joon Chang argues WTO trade rules are like 'pulling away the ladder they used themselves to climb up' (Kicking away the ladder at Amazon)
- Free trade may prevent developing economies develop their infant industries. For example, if a developing economy was trying to diversify their economy to develop a new manufacturing industry, they may be unable to do it without some tariff protection.
- WTO is being overshadowed by new TIPP trade deals. These deals are negotiated away from WTO and focuses mainly on US and EU. It excludes China, Russia, India, Brazil and South Africa. It threatens to diminish the global importance of WTO
- Difficulty of making progress. WTO trade deals have been quite difficult to form consensus. Various rounds have taken many years to slowly progress. It results in countries seeking alternatives such as TIPP or local bilateral deals.
- WTO trade deals still encompass a lot of protectionism in areas like agriculture. Protectionist tariffs which primarily benefit richer nations, such as the EU and US.
- WTO has implemented strong defense of TRIPs 'Trade Related Intellectual Property' rights These allow firms to implement patents and copyrights. In areas, such as life-saving drugs, it has raised the price and made it less affordable for developing countries.
- WTO has rules which favour multinationals. For example, 'most favoured nation' principle means countries should trade without discrimination. This has advantages but can mean developing countires cannot give preference to local contractors, but may have to choose foreign multinationals - whatever their history in repatriation of profit, investment in area.

WTO and India

- India was a founding member of the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organisation (WTO) in 1947.
- India's participation in a more rule-based system of international trade regulation will assure greater stability and predictability, which will lead to increased commerce and prosperity.
- Services exports account for 40% of India's overall commodities and services exports. The services sector accounts for more than 55 percent of India's GDP.
- Around 142 million people are employed in the sector (domestic and exports), accounting for 28 percent of the country's workforce.
- IT and IT-enabled services, travel and transportation, and financial services account for the majority of India's exports.
- The United States (33 percent), the European Union (15 percent), and other rich countries are the most popular destinations.
- India has a clear interest in the liberalization of services trade and wants industrialized countries to grant commercially meaningful access.

- It's vital to ensure food and livelihood security, especially in a big agrarian economy like India.
- India has been lobbying the WTO for a long-term solution to public stockholding subsidies.
- An interim agreement (a peace clause) on "public stockholding" continued exceptions that allow developing countries to stockpile agricultural products to protect against food shortages at the 2013 Ministerial Conference (MC9) in Bali.
- India is a big supporter of giving geographical indicators for products like Basmati rice, Darjeeling tea, and Alphonso mangoes the same level of protection as wines and spirits under the Trade-related Aspects of Intellectual Property Rights (TRIPS) accord.
- Non-trade topics such as labor standards, environmental protection, human rights, investment laws, and competition policy have been pushed into WTO agreements by developed countries.
- India opposes any inclusion of non-trade issues that are aimed at enforcing protectionist measures in the long run (based on non-trade issues, developed countries such as the United States and the European Union are attempting to ban the imports of certain goods such as textiles, processed foods, and so on), particularly against developing countries.

UNIT-2

Theories of International Trade and Theories of International Investment

THEORIES OF INTERNATIONAL TRADE

- International trade theories are simply different theories to explain international trade.
- Trade is the concept of exchanging goods and services between two people or entities.
- *International trade* is then the concept of this exchange between people or entities in two different countries.
- People or entities trade because they believe that they benefit from the exchange. They may need or want the goods or services.
- While at the surface, this many sound very simple, there is a great deal of theory, policy, and business strategy that constitutes international trade.

Classical or Country-Based Trade Theories

1. Mercantilism

- Developed in the sixteenth century, mercantilism was one of the earliest efforts to develop an economic theory.
- This theory stated that a country's wealth was determined by the amount of its gold and silver holdings.
- In its simplest sense, mercantilists believed that a country should increase its holdings of gold and silver by promoting exports and discouraging imports.
- In other words, if people in other countries buy more from you (exports) than they sell to you (imports), then they have to pay you the difference in gold and silver.
- The objective of each country was to have a trade surplus, or a situation where the value of exports are greater than the value of imports, and to avoid a trade deficit, or a situation where the value of imports is greater than the value of exports.
- A closer look at world history from the 1500s to the late 1800s helps explain why mercantilism flourished.
- The 1500s marked the rise of new nation-states, whose rulers wanted to strengthen their nations by building larger armies and national institutions.

- One way that many of these new nations promoted exports was to impose restrictions on imports. This strategy is called protectionism and is still used today.
- Nations expanded their wealth by using their colonies around the world in an effort to control more trade and amass more riches.
- The British colonial empire was one of the more successful examples; it sought to increase its wealth by using raw materials from places ranging from what are now the Americas and India. France, the Netherlands, Portugal, and Spain were also successful in building large colonial empires that generated extensive wealth for their governing nations.
- Although mercantilism is one of the oldest trade theories, it remains part of modern thinking.
- Countries such as Japan, China, Singapore, Taiwan, and even Germany still favor exports and discourage imports through a form of neo-mercantilism in which the countries promote a combination of protectionist policies and restrictions and domestic-industry subsidies.
- Nearly every country, at one point or another, has implemented some form of protectionist policy to guard key industries in its economy.
- While export-oriented companies usually support protectionist policies that favor their industries or firms, other companies and consumers are hurt by protectionism.
- Taxpayers pay for government subsidies of select exports in the form of higher taxes. Import restrictions lead to higher prices for consumers, who pay more for foreign-made goods or services.
- Free-trade advocates highlight how free trade benefits all members of the global community, while mercantilism's protectionist policies only benefit select industries, at the expense of both consumers and other companies, within and outside of the industry.

2. Absolute Advantage

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

3. Comparative Advantage

- The challenge to the absolute advantage theory was that some countries may be better at producing both goods and, therefore, have an advantage in *many* areas.
- In contrast, another country may not have *any* useful absolute advantages.

- To answer this challenge, David Ricardo, an English economist, introduced the theory of comparative advantage in 1817.
- Ricardo reasoned that even if Country had the absolute advantage in the production of *both* products, specialization and trade could still occur between two countries.
- Comparative advantage occurs when a country cannot produce a product more efficiently than the other country; however, it *can* produce that product better and more efficiently than it does other goods.
- The difference between these two theories is subtle.

p Comparative advantage focuses on the relative productivity differences, whereas absolute advantage looks at the absolute productivity.

4. Heckscher-Ohlin Theory (Factor Proportions Theory)

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

5. Leontief Paradox

- In the early 1950s, Russian-born American economist Wassily W. Leontief studied the US economy closely and noted that the United States was abundant in capital and, therefore, should export more capital-intensive goods.
- However, his research using actual data showed the opposite: the United States was importing more capital-intensive goods.
- According to the factor proportions theory, the United States should have been importing labor-intensive goods, but instead it was actually exporting them.
- His analysis became known as the Leontief Paradox because it was the reverse of what was expected by the factor proportions theory.
- In subsequent years, economists have noted historically at that point in time, labor in the United States was both available in steady supply and more productive than in many other countries; hence it made sense to export labor-intensive goods.
- Over the decades, many economists have used theories and data to explain and minimize the impact of the paradox.
- However, what remains clear is that international trade is complex and is impacted by numerous and often-changing factors.

- Trade cannot be explained neatly by one single theory, and more importantly, our understanding of international trade theories continues to evolve.

6. Modern or Firm-Based Trade Theories

- In contrast to classical, country-based trade theories, the category of modern, firm-based theories emerged after World War II and was developed in large part by business school professors, not economists.
- The firm-based theories evolved with the growth of the multinational company (MNC).
- The country-based theories couldn't adequately address the expansion of either MNCs or intra industry trade, which refers to trade between two countries of goods produced in the same industry.
- For example, Japan exports Toyota vehicles to Germany and imports Mercedes-Benz automobiles from Germany.
- Unlike the country-based theories, firm-based theories incorporate other product and service factors, including brand and customer loyalty, technology, and quality, into the understanding of trade flows.

7. Country Similarity Theory

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

8. Product Life Cycle Theory

- Raymond Vernon, a Harvard Business School professor, developed the product life cycle theory in the 1960s.
- The theory, originating in the field of marketing, stated that a product life cycle has three distinct stages: (1) new product, (2) maturing product, and (3) standardized product.
- The theory assumed that production of the new product will occur completely in the home country of its innovation.
- In the 1960s this was a useful theory to explain the manufacturing success of the United States.
- US manufacturing was the globally dominant producer in many industries after World War II.
- It has also been used to describe how the personal computer (PC) went through its product cycle.

- Today, the PC is in the standardized product stage, and the majority of manufacturing and production process is done in low-cost countries in Asia and Mexico.
- The product life cycle theory has been less able to explain current trade patterns where innovation and manufacturing occur around the world.
- For example, global companies even conduct research and development in developing markets where highly skilled labor and facilities are usually cheaper.
- Even though research and development is typically associated with the first or new product stage and therefore completed in the home country, these developing or
- emerging-market countries, such as India and China, offer both highly skilled labor and new research facilities at a substantial cost advantage for global firms.

9. Global Strategic Rivalry Theory

- Global strategic rivalry theory emerged in the 1980s and was based on the work of economists Paul Krugman and Kelvin Lancaster.
- Their theory focused on MNCs and their efforts to gain a competitive advantage against other global firms in their industry.
- Firms will encounter global competition in their industries and in order to prosper, they must develop competitive advantages.
- The critical ways that firms can obtain a sustainable competitive advantage are called the barriers to entry for that industry.
- The barriers to entry refer to the obstacles a new firm may face when trying to enter into an industry or new market.
- The barriers to entry that corporations may seek to optimize include:
    - research and development, the ownership of intellectual property rights, economies of scale, unique business processes or methods as well as extensive experience in the industry, and the control of resources or favorable access to raw materials.

Porter's National Competitive Advantage Theory

- In the continuing evolution of international trade theories, Michael Porter of Harvard Business School developed a new model to explain national competitive advantage in 1990.
- Porter's theory stated that a nation's competitiveness in an industry depends on the capacity of the industry to innovate and upgrade.
- His theory focused on explaining why some nations are more competitive in certain industries. To explain his theory, Porter identified four determinants that he linked together.
- The four determinants are (1) local market resources and capabilities, (2) local market demand conditions, (3) local suppliers and complementary industries, and (4) local firm characteristics.

Local market resources and capabilities (factor conditions).

- Porter recognized the value of the factor proportions theory, which considers a nation's resources (e.g., natural resources and available labor) as key factors in determining what products a country will import or export.
- Porter added to these basic factors a new list of advanced factors, which he defined as skilled labor, investments in education, technology, and infrastructure.
- He perceived these advanced factors as providing a country with a sustainable competitive advantage.

Local market demand conditions.

- Porter believed that a sophisticated home market is critical to ensuring ongoing innovation, thereby creating a sustainable competitive advantage.

- Companies whose domestic markets are sophisticated, trendsetting, and demanding forces continuous innovation and the development of new products and technologies.
- Many sources credit the demanding US consumer with forcing US software companies to continuously innovate, thus creating a sustainable competitive advantage in software products and services.

Local suppliers and complementary industries.

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

Local firm characteristics.

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

THEORIES OF INTERNATIONAL INVESTMENT

Monopolistic Advantage Theory

- Stefan Hymer saw the role of firm-specific advantages as a way of marrying the study of direct foreign investment with classic models of imperfect competition in product markets. He argued that a direct foreign investor possesses some kind of proprietary or monopolistic advantage not available to local firms.
- These advantages must be economies of scale, superior technology, or superior knowledge in marketing, management, or finance.
- Foreign direct investment took place because of the product and factor market imperfections.
- The direct investor is a monopolist or, more often, an oligopolistic in product markets.
- Humer implied that governments should be ready to impose controls on it.

2. Product and Factor Market Imperfection

- Caves (1971) expanded Hymer's theory and hypothesized that the ability of firms to differentiate their products - particularly high income consumer goods and services - may be key ownership advantages of firms leading to foreign production.
- The consumers would prefer to similar locally made goods and thus would give the firm some control over the selling price and an advantage over indigenous firms.
- To support these contentions, Caves noted that companies investing overseas were in industries that typically engaged in heavy product research and marketing effort.

3. International Product Life cycle

The international product life cycle theory explains that foreign direct investment is a natural stage in the life of a product.

4. Other Theories

The Knickerbocker's **follow-the-leader theory** argued that, as risk minimizers oligopolistic, wishing to avoid destructive competition, would normally follow each other into (e.g., foreign) markets, to safeguard their own commercial interests. This theory is considered defensive because competitors are investing to avoid losing the markets served by exports when their initial investor begins local production. They may also fear that the initiator will achieve some advantage of risk diversification that they will have unless they also enter the market.

5. Cross Investment Theory

Graham noted a tendency for cross investment by European and American firms in certain oligopolistic industries; that is, European firms tended to invest in the United States when American companies had gone to Europe.
He postulated that such investments would permit the American subsidiaries of European firms to retaliate in the home market of U.S. companies if the European subsidiaries of these companies initiated some aggressive tactic, such as price cutting, in the European market.

6. The Internalization Theory

- Is an extension of the market imperfection theory. By investing in a foreign subsidiary rather than licensing, the company is able to sent the knowledge across borders while maintaining it within the firm, where it presumably yields a better return on the investment made to produce it.
- Other theories relate to financial factors. Robert Aliber believes the imperfections in the foreign exchange markets may be responsible for foreign investment.
- He explained this in terms of the ability of firms from countries with strong currencies to borrow or raise capital in domestic or foreign markets with weak currencies, which, in turn, enabled them to capitalize their expected income streams at different rates of interest. Structural imperfections in the foreign exchange market allow firms to make foreign exchange gains through the purchase or sales of assets in an undervalued or overvalued currency.
- One other financially based theory (portfolio theory) was put by Rugman, Agmon and Lessard.
- These researchers argued that international operations allow for a diversification of risk and therefore tend to maximize the expected return on investment.
- Rugman and Lessard have further argued that the location of the foreign direct investment would be a function of both the firm's perception of the uncertainties involved and the geographical distribution of its existing assets.

7. The Eclectic Paradigm

The eclectic paradigm is developed by John Dunning seeks to offer a general framework for determining the extent and pattern of both foreign-owned production undertaken by a country's own enterprises and also that of domestic production owned by foreign enterprises.

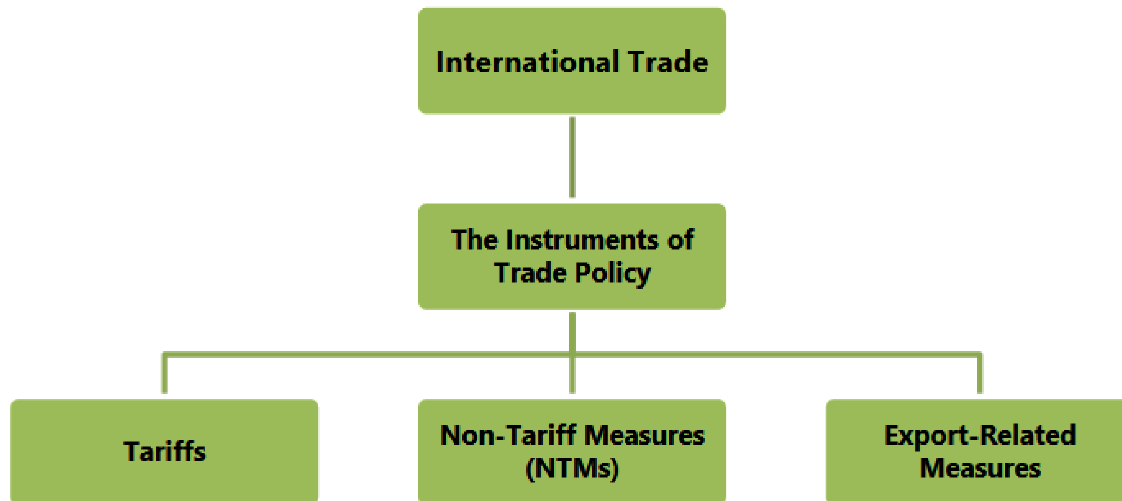
8. Industrial Organization Theory

 Mainly explains the nature of the ownership **(O)** advantages that arise:
(1) From the possession of particular intangible assets - assets advantages (Oa);
(2) From the ability of the firm to coordinate multiple and geographically dispersed value-added activities and to capture the gains of risk diversification- transaction cost minimizing advantages (Ot).

- The theory of property rights and the internalization paradigm explain why firms engage in foreign activity to exploit or acquire these advantages.
- Theories of location and tradeexplain the factors determining the siting of production.
- Theories of oligopoly and business strategy explain the likely reaction of firms to particular OLI configurations.
- The eclectic paradigm suggests that all forms of foreign production by all countries can be explained by reference to the above conditions.
- Dunning further argued that the eclectic paradigm offers the basis for a general explanation of international production.
- The propensity of enterprises of a particular nationality to engage in foreign direct investment will vary according to the economic *et al.* specific characteristics of their home country and the country(ies) in which they propose to invest, the range and types of

products they intend to produce, and their underlying management and organizational strategies.

INTERNATIONALISATION-INSTRUMENTS OF TRADE POLICY



Trade policy encompasses all instruments that governments may use to promote or restrict imports and exports. Trade policy also includes the approach taken by countries in trade negotiations. While participating in the multilateral trading system and/or while negotiating bilateral trade agreements, countries assume obligations that shape their national trade policies. The instruments of trade policy that countries typically use to restrict imports and/ or to encourage exports can be broadly classified into price- related measures such as tariffs and non-price measures or non-tariff measures (NTMs).

TARIFFS

Tariffs, also known as customs duties, are basically taxes or duties imposed on goods and services which are imported or exported. It is defined as a financial charge in the form of a tax, imposed at the border on goods going from one customs territory to another. They are the most visible and universally used trade measures that determine market access for goods. Import duties being pervasive than export duties, tariffs are often identified with import duties and in this unit, the term 'tariff' would refer to import duties. Tariffs are aimed at altering the relative prices of goods and services imported, so as to contract the domestic demand and thus regulate the volume of their imports. Tariffs leave the world market price of the goods unaffected; while raising their prices in the domestic market. The main goals of tariffs are to raise revenue for the government, and more importantly to protect the domestic import-competing industries.

Forms of Import Tariffs:

(i) **Specific Tariff:** A specific tariff is an import duty that assigns a fixed monetary tax per physical unit of the good imported. It is calculated on the basis of a unit of measure, such as weight, volume, etc., of the imported good. Thus, a specific tariff of `1000/ may be charged on each imported bicycle.

The disadvantage of specific tariff as an instrument for protection of domestic producers is that its protective value varies inversely with the price of the

import. For example: if the price of the imported cycle is ` 5,000/,then the rate of tariff is 20%; if due to inflation, the price of bicycle rises to ` 10,000 , the specific tariff is only 10% of the value of the import. Since the calculation of these duties does not involve the value of merchandise, customs valuation is not applicable in this case.

(ii) **Ad valorem tariff:** An ad valorem tariff is levied as a constant percentage of the monetary value of one unit of the imported good. A 20% ad valorem tariff on any bicycle generates a `1000/ payment on each imported bicycle priced at `5,000/ in the world market; and if the price rises to ` 10,000, it generates a payment of `2,000/. While ad valorem tariff preserves the protective value of tariff on home producer, it gives incentives to deliberately undervalue the good's price on invoices and bills of lading to reduce the tax burden. Nevertheless, ad valorem tariffs are widely used the world over. There are many other variations of the above tariffs, such as:

(a) Mixed Tariffs : Mixed tariffs are expressed either on the basis of the value of the imported goods (an ad valorem rate) or on the basis of a unit of measure of the imported goods (a specific duty) depending on which generates the most income(or least income at times) for the nation. For example, duty on cotton: 5 per cent ad valorem 0r ` 3000/per tonne, whichever is higher.

(b) Compound Tariff or a Compound Duty is a combination of an ad valorem and a specific tariff. That is, the tariff is calculated on the basis of both the value of the imported goods (an ad valorem duty) and a unit of measure of the imported goods (a specific duty). It is generally calculated by adding up a specific duty to an ad valorem duty. For example: duty on cheese at 5 per cent advalorem plus 100 per kilogram

(c) Technical/Other Tariff: These are calculated on the basis of the specific contents of the imported goods i.e the duties are payable by its components or related items. For example: `3000/ on each solar panel plus ` 50/ per kg on the battery.

(d) Tariff Rate Quotas: Tariff rate quotas (TRQs) combine two policy instruments: quotas and tariffs. Imports entering under the specified quota portion are usually subject to a lower (sometimes zero), tariff rate. Imports above the quantitative threshold of the quota face a much higher tariff.

(e) Most-Favored Nation Tariffs: MFN tariffs are what countries promise to impose on imports from other members of the WTO, unless the country is part of a preferential trade agreement (such as a free trade area or customs union). This means that, in practice, MFN rates are the highest (most restrictive) that WTO members charge one another. Some countries impose higher tariffs on countries that are not part of the WTO.

(f) Variable Tariff: A duty typically fixed to bring the price of an imported commodity up to the domestic support price for the commodity.

(g) Preferential Tariff: Nearly all countries are part of at least one preferential trade agreement, under which they promise to give another country's products lower tariffs than their MFN rate. These agreements are reciprocal. A lower tariff is charged from goods imported from a country which is given preferential treatment. Examples are preferential duties in the EU region under which a good coming into one EU country to another is charged zero tariffs. Another example is North American Free Trade Agreement (NAFTA) among Canada, Mexico and the USA where the preferential tariff rate is zero on essentially all products. Countries, especially the affluent ones also grant 'unilateral preferential treatment' to select list of products from specified developing countries .The Generalized System of Preferences (GSP) is one

such system which is currently prevailing.

(h) Bound Tariff : A bound tariff is a tariff which a WTO member binds itself with a legal commitment not to raise it above a certain level. By binding a tariff, often during negotiations, the members agree to limit their right to set tariff levels beyond a certain level. The bound rates are specific to individual products and represent the maximum level of import duty that can be levied on a product imported by that member. A member is always free to impose a tariff that is lower than the bound level. Once bound, a tariff rate becomes permanent and a member can only increase its level after negotiating with its trading partners and compensating them for possible losses of trade. A bound tariff ensures transparency and predictability.

(i) Applied Tariffs: An 'applied tariff' is the duty that is actually charged on imports on a most-favoured nation (MFN) basis. A WTO member can have an applied tariff for a product that differs from the bound tariff for that product as long as the applied level is not higher than the bound level.

(j) Escalated Tariff structure refers to the system wherein the nominal tariff rates on imports of manufactured goods are higher than the nominal tariff rates on intermediate inputs and raw materials, i.e the tariff on a product increases as that product moves through the value-added chain. For example a four percent tariff on iron ore or iron ingots and twelve percent tariff on steel pipes. This type of tariff is discriminatory as it protects manufacturing industries in importing countries and dampens the attempts of developing manufacturing industries of exporting countries. This has special relevance to trade between developed countries and developing countries. Developing countries are thus forced to continue to be suppliers of raw materials without much value addition.

(k) Prohibitive tariff: A prohibitive tariff is one that is set so high that no imports will enter.

(l) Import subsidies: In some countries, import subsidies also exist. An import subsidy is simply a payment per unit or as a percent of value for the importation of a good (i.e., a negative import tariff).

(m) Tariffs as Response to Trade Distortions: Sometimes countries engage in 'unfair' foreign-trade practices which are trade distorting in nature and adverse tothe interests of the domesticfirms. The affected importing countries, upon confirmation of the distortion, respond quickly by measures in the form of tariff responses to offset the distortion. These policies are often referred to as "trigger-price" mechanisms. The following sections relate to such tariff responses to distortions related to foreign dumping and export subsidies

(i) Anti-dumping Duties: Dumping occurs when manufacturers sell goods in a foreign country below the sales prices in their domestic market or below their full average cost of the product. Dumping may be persistent, seasonal, or cyclical. Dumping may also be resorted to as a predatory pricing practice to drive out established domestic producers from the market and to establish monopoly position. Dumping is an international price discrimination avouring buyers of exports, but in fact, the exporters deliberately forego money in order to harm the domestic producers of the importing country. This is unfair and constitutes a threat to domestic producers and therefore when dumping is found, anti-dumping measures which are tariffs to offset the effects of dumping may be initiated as a safeguard instrument by imposition of additional import duties so as to offset the foreign firm's unfair price advantage. This is justified only if the domestic industry is seriously

is, the associated costs to consumers would be less than the benefits that would accrue to producers). For example: In January 2017, India imposed anti-dumping duties on colour-coated or pre-painted flat steel products imported into the country from China and European nations for a period not exceeding six months and for jute and jute products from Bangladesh and Nepal.

(ii) Countervailing Duties: Countervailing duties are tariffs that aim to offset the artificially low prices charged by exporters who enjoy export subsidies and tax concessions offered by the governments in their home country. If a foreign country does not have a comparative advantage in a particular good and a government subsidy allows the foreign firm to be an exporter of the product, then the subsidy generates a distortion from the free-trade allocation of resources. In such cases, CVD is charged in an importing country to negate the advantage that exporters get from subsidies to ensure fair and market oriented pricing of imported products and thereby protecting domestic industries and firms. For example, in 2016, in order to protect its domestic industry, India imposed 12.5% countervailing duty on Gold jewellery imports from ASEAN

Effects of Tariffs

A tariff levied on an imported product affects both the country exporting a product and the country importing that product.

(i) Tariff barriers create obstacles to trade, decrease the volume of imports and exports and therefore of international trade. The prospect of market access of the exporting country is worsened when an importing country imposes a tariff.

(ii) By making imported goods more expensive, tariffs discourage domestic consumers from consuming imported foreign goods. Domestic consumers suffer a loss in consumer surplus because they must now pay a higher price.

 for the good and also because compared to free trade quantity, they now consume lesser quantity of the good.

(iii) Tariffs encourage consumption and production of the domestically produced import substitutes and thus protect domestic industries.

(iv) Producers in the importing country experience an increase in well-being as a result of imposition of tariff. The price increase of their product in the domestic market increases producer surplus in the industry. They can also charge higher prices than would be possible in the case of free trade because foreign competition has reduced.

(v) The price increase also induces an increase in the output of the existing firms and possibly addition of new firms due to entry into the industry to take advantage of the new high profits and consequently an increase in employment in the industry.

(vi) Tariffs create trade distortions by disregarding comparative advantage and prevent countries from enjoying gains from trade arising from comparative advantage. Thus, tariffs discourage efficient production in the rest of the world and encourage inefficient production in the home country.

(vii) Tariffs increase government revenues of the importing country by the value of the total tariff it charges. Trade liberalization in recent decades, either through government policy measures or through negotiated reduction through the WTO or regional and bilateral free trade agreements, has diminished the importance of tariff as a tool of protection. Currently, trade policy is focusing increasingly on not so easily observable forms of trade barriers usually called nontariff measures (NTMs). NTMs are thought to have important restrictive and distortionary effects on international trade. They have become so invasive that the benefits due to tariff reduction are practically offset by them.

NON -TARIFF MEASURES (NTMS)

Non-tariff measures (NTMs) are policy measures, other than ordinary customs tariffs, that can potentially have an economic effect on international trade in goods, changing quantities traded, or prices or both (UNCTAD, 2010). Non-tariff measures comprise all types of measures which alter the conditions of international trade, includingpolicies and regulations that restrict trade and those that facilitate it. It should be kept in mind that NTMs are not the same as non-tariff barriers (NTBs). Compared to non-tariff barriers which are simply discriminatory non-tariff measures imposed by governments to favour domestic over foreign suppliers, non- tariff measures encompass a broader set of measures. According to WTO agreements, the use of NTMs is allowed under certain circumstances. Examples of this include the Technical Barriers to Trade (TBT) Agreement and the Sanitary and Phytosanitary Measures (SPS) Agreement, both negotiated during the Uruguay Round. However, NTMs are sometimes used as a means to circumvent free-trade rules and favour domestic industries at the expense of foreign competition. In this case they are called non-tariff measures (NTMs). It is very difficult, and sometimes impossible, to distinguish legitimate NTMs from protectionist NTMs, especially as the same measure may be used for several reasons.

Depending on their scope and/or design NTMs are categorized as:

I. Technical Measures:

Technical measures refer to product-specific properties such as characteristics of the product, technical specifications and production processes. These measures are intended for ensuring product quality, food safety, environmental protection, national security and protection of animal and plant health.

II. Non-technical Measures:

Non-technical measures relate to trade requirements; for example; shipping requirements, custom formalities, trade rules, taxation policies, etc. These are further distinguished as:

(a) Hard measures (e.g. Price and quantity control measures),

(b) Threat measures (e.g. Anti-dumping and safeguards) and

(c) Other measures such as trade-related finance and investment measures. Furthermore, the categorization also distinguishes between:

(i) Import-related measures which relate to measures imposed by the importing country, and

(ii) Export-related measures which relate to measures imposed by the exporting country itself.

(iii) In addition, to these, there are procedural obstacles (PO) which are practical problems in administration, transportation, delays in testing, certification etc that may make it difficult for businesses to adhere to a given regulation.

Technical Measures

I Sanitary and Phytosanitary (SPS) Measures:

SPS measures are applied to protect human, animal or plant life from risks arising from additives, pests, contaminants, toxins or disease-causing organisms and to protect biodiversity. These include ban or prohibition of import of certain goods, all measures governing quality and hygienic requirements, production processes, and associated compliance assessments. For example; prohibition of import of poultry from countries affected by avian flu, meat and poultry processing standards to reduce pathogens, residue limits for pesticides in foods etc.

II Technical Barriers To Trade (TBT):

Technical Barriers to Trade (TBT) which cover both food and non-food traded products refer to mandatory 'Standards and Technical Regulations' that define the specific characteristics that a product should have, such as its size, shape, design, labelling / marking / packaging, functionality or performance and production methods, excluding measures covered by the SPS Agreement. The specific procedures used to check whether a product is really conforming to these requirements (conformity assessment procedures e.g. testing, inspection and certification) are

also covered in TBT. This involves compulsory quality, quantity and price control of goods before shipment from the exporting country. Just as SPS, TBT measures are standards-based measures that countries use to protect their consumers and preserve natural resources, but these can also be used effectively as obstacles to imports or to discriminate against imports and protect domestic products.

Non-technical Measures

These include different types of trade protective measures which are put into operation to neutralize the possible adverse effects of imports in the market of the importing country. Following are the most commonly practiced measures in respect of imports:

(i) **Import Quotas:** An import quota is a direct restriction which specifies that only a certain physical amount of the good will be allowed into the country during a given time period, usually one year. Import quotas are typically set below the free trade level of imports and are usually enforced by issuing licenses. This is referred to as a binding quota; a non-binding quota is a quota that is set at or above the free trade level of imports, thus having little effect on trade.

Import quotas are mainly of two types: absolute quotas and tariff-rate quotas. Absolute quotas or quotas of a permanent nature limit the quantity of imports to a specified level during a specified period of time and the imports can take place any time of the year. No condition is attached to the country of origin of the product. For example: 1000 tonnes of fish import of which can take place any time of the year from any country. When country allocation is specified, a fixed volume or value of the product must originate in one or more countries. Example: A quota of 1000 tonnes of fish that can be imported any time of the year, but where 750 tonnes must originate in country A and 250 tonnes in country B. In addition, there are seasonal quotas and temporary quotas. With a quota, the government, of course, receives no revenue. The profits received by the holders of such import licenses are known as 'quota rents'. While tariffs directly interfere with prices that can be charged for an imported good in the domestic market, import quota interferes with the market prices indirectly. Obviously, an import quota at all times raises the domestic price of the imported good. The license holders are able to buy imports and resell them at a higher price in the domestic market and they will be able to earn a 'rent' on their operations over and above the profit they would have made in a free market

(ii) **Price Control Measures:** Price control measures (including additional taxes and charges) are steps taken to control or influence the prices of imported goods in order to support the domestic price of certain products when the import prices of these goods are lower. These are also known as 'para-tariff' measures and include measures, other than tariff measures, that increase the cost of imports in a similar manner, i.e. by a fixed percentage or by a fixed amount. Example: A minimum import price established for sulphur.

(iii) **Non-automatic Licensing and Prohibitions :** These measures are normally aimed at limiting the quantity of goods that can be imported, regardless of whether they originate from different sources or from one particular supplier. These measures may take the form of non-automatic licensing, or through complete prohibitions. For example, textiles may be allowed only on a discretionary license by the importing country. India prohibits import/export of arms and related material from/to Iraq. Also, India prohibits many items (mostly of animal origin) falling under 60 EXIM codes.

(iv) **Financial Measures:** The objective of financial measures is to increase import costs by regulating the access to and cost of foreign exchange for imports and to define the terms of payment. It includes measures such as advance payment requirements and foreign exchange controls denying the use of foreign exchange

for certain types of imports or for goods imported from certain countries. For example, an importer may be required to pay a certain percentage of the value of goods imported three months before the arrival of goods or foreign exchange may not be permitted for import of newsprint.

(v) Measures Affecting Competition: These measures are aimed at granting exclusive or special preferences or privileges to one or a few limited group of economic operators. It may include government imposed special import channels or enterprises, and compulsory use of national services. For example, a statutory marketing board may be granted exclusive rights to import wheat: or a canalizing agency (like State Trading Corporation) may be given monopoly right to distribute palm oil. When a state agency or a monopoly import agency sells on the domestic market at prices above those on the world market, the effect will be similar to an import tariff.

(vi) Government Procurement Policies: Government procurement policies may interfere with trade if they involve mandates that the whole of a specified percentage of government purchases should be from domestic firms rather than foreign firms, despite higher prices than similar foreign suppliers. In accepting public tenders, a government may give preference to the local tenders rather than foreign tenders.

(vii) Trade-Related Investment Measures: These measures include rules on local content requirements that mandate a specified fraction of a final good should be produced domestically.

(a) requirement to use certain minimum levels of locally made components, (25 percent of components of automobiles to be sourced domestically)

(b) restricting the level of imported components , and

(c) limiting the purchase or use of imported products to an amount related to the quantity or value of local products that it exports. (A firm may import only up to 75 % of its export earnings of the previous year)

(viii) Distribution Restrictions: Distribution restrictions are limitations imposed on the distribution of goods in the importing country involving additional license or certification requirements. These may relate to geographical restrictions or restrictions as to the type of agents who may resell. For example: a restriction that imported fruits may be sold only through outlets having refrigeration facilities

(ix) Restriction on Post-sales Services: Producers may be restricted from providing after- sales services for exported goods in the importing country. Such services may be reserved to local service companies of the importing country.

(x) Administrative Procedures: Another potential obstruction to free trade is the costly and time consuming administrative procedures which are mandatory for import of foreign goods. These will increase transaction costs and discourage imports. The domestic import-competing industries gain by such non- tariff measures. Examples include specifying particular procedures and formalities, requiring licenses, administrative delay, red-tape and corruption in customs clearing frustrating the potential importers , procedural obstacles linked to prove compliance etc.

(xi) Rules of origin: Rules of origin are the criteria needed by governments of importing countries to determine the national source of a product. Their importance is derived from the fact that duties and restrictions in several cases depend upon the source of imports. Important procedural obstacles occur in the home countries for making available certifications regarding origin of goods, especially when different components of the product originate in different countries.

(Xii) Safeguard Measures are initiated by countries to restrict imports of a product temporarily if its domestic industry is injured or threatened with serious injury caused by a surge in imports.

(Xiii) Embargos : An embargo is a total ban imposed by government on import or export of some or all commodities to particular country or regions for a specified or indefinite period. This may be done due to political reasons or for other reasons such as health, religious sentiments. This is the most extreme form of trade barrier

Voluntary Export Restraints :

Voluntary Export Restraints (VERs) refer to a type of informal quota administered by an exporting country voluntarily restraining the quantity of goods that can be exported out of that country during a specified period of time. Such restraints originate primarily from political considerations and are imposed based on negotiations of the importer with the exporter.

A voluntary export restraint (VER) is a trade restriction on the quantity of a good that an exporting country is allowed to export to another country. This limit is self-imposed by the exporting country.

Voluntary export restraints (VERs) fall under the broad category of non-tariff barriers, which are restrictive trade barriers, like quotas, embargoes, sanctions levies, and other restrictions. Typically, VERs are a result of requests made by the importing country to provide a measure of protection for its domestic businesses that produce competing goods, though these agreements can be reached at the industry level, as well.

- A voluntary export restraint (VER) is a self-imposed limit on the quantity of a good that an exporting country is allowed to export.
- VERs are considered non-tariff barriers, which are restrictive trade barriers—such as quotas and embargoes.
- Related to a voluntary import expansion, which is meant to allow for more imports, and can include lowering tariffs or dropping quotas.

Administrative Policy

Countries are sometimes accused of using their various administrative rules (e.g. regarding food safety, environmental standards, electrical safety, etc.) as a way to introduce barriers to imports.

Anti-Dumping Duty

Anti-dumping duty is a tariff imposed on imports manufactured in foreign countries that are priced below the fair market value of similar goods in the domestic market. The government imposes
anti-dumping duty on foreign imports when it believes that the goods are being “dumped” – through the low pricing – in the domestic market. Anti-dumping duty is imposed to protect local businesses and markets from unfair competition by foreign imports.
Dumping is, in general, a situation of international price discrimination, where the price of a product when sold to the importing country is less than the price of the same product when sold in the market of the exporting country. Anti- Dumping laws basically comprise the provisions that govern such practices. In the globalize economy, dumping is one of the most controversial issues and so are the anti-dumping laws.

History

The origin of the anti-dumping legislation can be traced back to the 19th century, when the European sugar industries appealed to their respective governments for protection against sugar being dumped at unfairly low prices. In 1902, there was a formal agreement on anti-dumping. Canada adopted the first anti-dumping law in 1904, followed by the European countries and then the US in 1916. The US law, as modified in 1921, and the Canadian one, formed the basis for the original GATT article (Article VI of GATT) on anti-dumping in 1947. Subsequently, codes on anti dumping were developed during the Kennedy Round (1962-67) and Tokyo Round (1973-

However, these were not binding on all GATT members; they were open to signature by those countries that wished to do so. They were plurilateral agreements, not multilateral ones. Unlike these, the Uruguay Round, (1986-94) anti-dumping agreement is a multilateral agreement binding on all GATT or WTO members.

Terms used

Normal Value: Normal value is the comparable price at which the goods under complaint are sold, in the ordinary course of trade, in the domestic market of the exporting country f the normal value cannot be determined by means of the domestic sales, the following two alternative methods may be employed to determine the normal value: -

- Comparable representative export price to an appropriate third country.
- Constructed normal value, i.e. the cost of production in the country of origin with reasonable addition for administrative, selling and general costs and reasonable profits.

Export price: The Export price of the allegedly dumped goods means the price at which it is exported to the complaining country. It is generally the CIF value minus the adjustments on account of ocean freight, insurance, commission, etc. so as to arrive at the value at ex-factory level.

Dumping Margin: The margin of dumping is the difference between the Normal value and the export price of the goods under complaint. It is generally expressed as a percentage of the export price. To ensure dumping activities do not affect the domestic market, the Indian government has imposed **anti-dumping duties against an exporter who causes any material or substantial injury to a domestic industry in India**. The anti-dumping law in India is the Customs Tariff Act, 1975, which was amended in 1995

Types of Dumping

Below are the four types of dumping in international trade:

1. Sporadic dumping

Companies dump excess unsold inventories to avoid price wars in the home market and preserve their competitive position. They can either dump by destroying excess supplies or export them to a foreign market where the products are not sold.

2. Predatory dumping

Unlike sporadic dumping, which is occasional, predatory dumping is permanent. It involves the sale of goods in a foreign market at a price lower than the home market. Predatory dumping is done to gain access to the foreign market and eliminate competition. It creates a monopoly in the market.

3. Persistent dumping

When a country consistently sells products at a lower price in the foreign market than the local prices, it is called persistent dumping. It happens when there is a constant demand for the product in the foreign market.

4. Reverse dumping

Reverse dumping happens when the demand for the product in the foreign market is less elastic. It means that price changes do not impact demand. Therefore, the company can charge a higher price in the foreign market and a lower price in the local market.

Advantages of Dumping

- Consumers in the importer’s country can gain access to products at lower prices.
- Exporters receive subsidies from their government to sell at lower prices abroad.
- The exporter’s country can generate employment and become industry leaders.

Disadvantages of Dumping

- The debt of the exporter's country will increase due to subsidies provided to sell at lower prices abroad.
- Dumping is expensive, and it will take the exporters years to sell at a lower price and put competitors out of business.
- The target company can retaliate and cause a trade war.

The World Trade Organization's and the European Union's Fight against Dumping

The World Trade Organization (WTO) and the European Union (EU) continuously take measures to discourage countries from dumping by imposing tariffs and taxes.

The WTO's Role

Member countries of the WTO lay down principles during the negotiation of the General Agreement on Trade and Tariff (GATT), where they agree not to dump and enforce tariffs on each other.

According to the WTO, if a country wants to put an anti-dumping tariff on a trading partner, then that country needs to prove the occurrence of the dumping and its impact on the local market.

They also need to show that the dumped price is much lower than the exporter's domestic price. The disputing country should also determine the normal price before the anti-dumping tariff is in place.

The EU's Role

Like the WTO, the European Union also enforces anti-dumping measures through its economic arm – the European Commission (EC). If a member country accuses a trading partner of dumping, the EC needs to find that dumping has caused material harm to the complainant.

Before imposing the duties, the EC must find that the dumping has caused material harm to the local market. It also needs to ensure that the anti-dumping duties do not violate the best interests of the EU.

If found guilty, the exporter can agree to sell at a minimum price, and duties can be imposed if the EU rejects the price offered by the exporter.

Causes of Illegal Dumping

- Population growth.
- High levels of waste production per capita.
- Disposal fees.
- Laziness.
- People do not care.
- Lack of education.
- Low fines.
- Bribing.

Anti-dumping measures include:

- Anti-dumping investigations;
  Anti-dumping investigations are procedures initiated and conducted either following a complaint by the domestic industry producing the like product or, in some situations, investigations that are self-initiated by authorities in the importing country (*ex officio* investigations) to determine whether a product is being dumped and is injuring national producers (or a third country's exporters) of the like product. Provisional duties may be applied during the investigation.
- Anti-dumping duties;
  Anti-dumping duties are duties levied on imports of a particular good originating from a specific trading partner to offset injurious dumping found to exist as the result of an

- Price undertakings.
  Price undertakings are undertakings by exporters to increase their export price to avoid the imposition of antidumping duties.

The balance of payment is the statement that files all the transactions between the entities, government anatomies, or individuals of one country to another for a given period of time. All the transaction details are mentioned in the statement, giving the authority a clear vision of the flow of funds. After all, if the items are included in the statement, then the inflow and the outflow of the fund should match. For a country, the balance of payment specifies whether the country has an excess or shortage of funds. It gives an indication of whether the country's export is more than its import or vice versa.

Types of Balance of Payment

The balance of payment is divided into three types:

Current account: It deals with current, ongoing, short term transactions like trade in goods, services (invisible) etc. It reflects the nation's net income. For instance, if you a buy a laptop from US, it will be a current account transaction and it will be debit on current account as you have to pay to US. There are 4 components of Current Account:

1. Goods – trade in goods
2. Services (invisible) – trade in services e.g. tourism
3. Income – investment income
4. Current unilateral transfers – donations, gifts, grants, remittances Note that grants might appear as component of capital account but are included in current account as they are unilateral, create no liability. Recipient does not have to give anything back in return.

Capital account: It deal with capital transactions i.e. those transactions which create assets or liabilities. It reflects the net changes in the ownership of national assets.
For instance, if you buy a stocks or property in US, it will be a capital account transaction and it will be debit on capital account as you have to pay to US to buy the asset.

Components of Capital Account

1. Foreign Direct Investment (FDI)
2. Foreign Portfolio Investment (FPI)
3. External Borrowings such as ECB
4. Reserve Account with the Central Bank

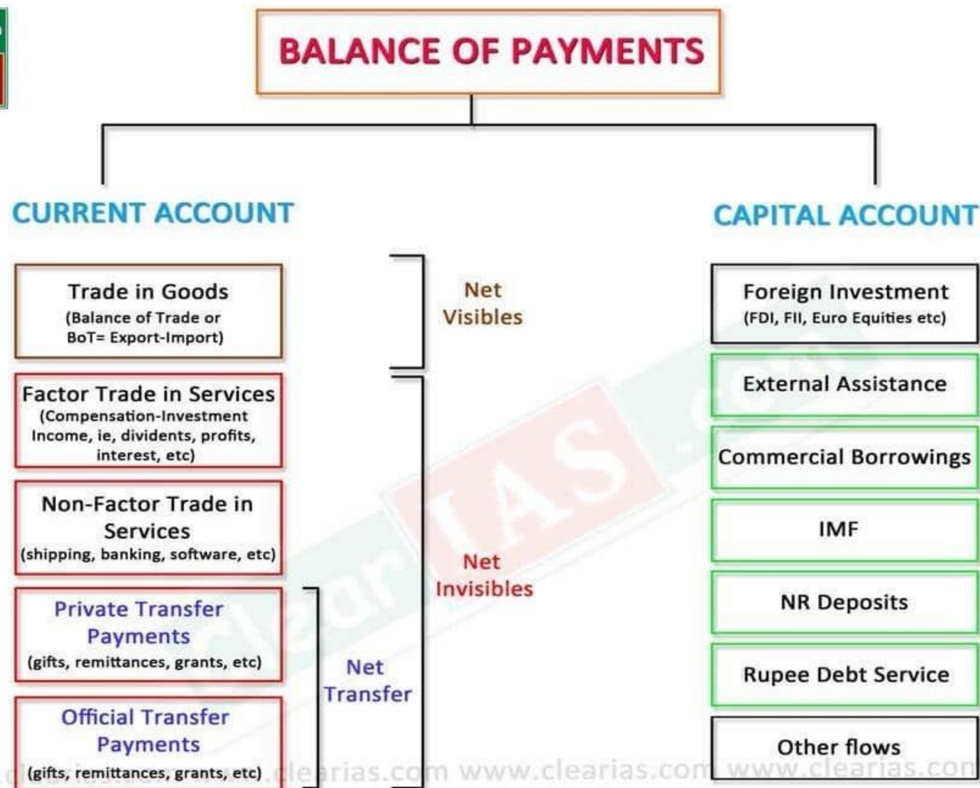
Finance account: The funds that flow to and from the other countries through investments like real estate, foreign direct investments, business enterprises, etc., is recorded in this account. This account calculates the foreign proprietor of domestic assets and domestic proprietor of foreign assets, and analyses if it is acquiring or selling more assets like stocks, gold, equity, etc.

Importance of Balance of Payment

A balance of payment is an essential document or transaction in the finance department as it gives the status of a country and its economy. The importance of the balance of payment can be calculated from the following points:

- It examines the transaction of all the exports and imports of goods and services for a given period.
- It helps the government to analyse the potential of a particular industry export growth and formulate policy to support that growth.
- It gives the government a broad perspective on a different range of import and export tariffs. The government then takes measures to increase and decrease the tax to discourage import and encourage export, respectively, and be self-sufficient.

- If the economy urges support in the mode of import, the government plans according to the BOP, and divert the cash flow and technology to the unfavourable sector of the economy, and seek future growth.
- The balance of payment also indicates the government to detect the state of the economy, and plan expansion. Monetary and fiscal policy are established on the basis of balance of payment status of the country.



How is the Balance of Payments Calculated?

The sum of the current account and capital account indicates the overall balance, which could either be in surplus or in deficit.

Balance of Payments is the net credit in Current Account and Capital Account.

BoP = net credit in (Current Account + Capital Account and Financial Account).

BoP Deficit or Surplus

- The decrease (increase) in official reserves is called the overall balance of payments deficit (surplus).
- The balance of payments deficit or surplus is obtained after adding the current and capital account balances.
- The balance of payments surplus will be considered as an addition to official reserves (reserve use).

BoP Crisis

- Countries with current account deficits can run into difficulties. If the deficit is large and the economy is not able to attract enough inflows of foreign investment, then their currency reserves will dwindle.
- There may come a point when the country needs to seek emergency borrowing from institutions such as the International Monetary Fund, that may lead to external debt.
- Countries with deficits in their current accounts will build up increasing debt and/or see increased foreign ownership of their assets.
- BoP crisis is also known as the currency crisis.

Autonomous Transactions vs Accommodating Transactions

- International economic transactions are called autonomous when transactions are made independently of the state of the BoP (for instance due to profit motive).
- These items are called 'above the line' items in the BoP.
- The balance of payments is said to be in surplus (deficit) if autonomous receipts are greater (less) than autonomous payments.
- Accommodating transactions (termed 'below the line' items), on the other hand, are determined by the net consequences of the autonomous items, that is, whether the BoP is in surplus or deficit.
- The **official reserve transactions** are seen as the accommodating item in the BoP (all others being autonomous).

Errors and Omissions

Errors and Omissions constitute the third element in the BoP (apart from the current and capital accounts) which is the 'balancing item' reflecting our inability to record all international transactions accurately.

What is Current Account Deficit?

It's simply deficit on all 4 components of current account.
(Export – Import) + Net income from abroad + Net Transfers
(Export – Import) is trade deficit
CAD = Trade Deficit + Net Income From Abroad + Net transfers
Note that Trade Deficit and CAD are not one and the same. Trade deficit is only a component of CAD.

What does deficit on Current Account imply?

If we forget income and transfers for a moment, what it means is that we import more than what we export.

How do we pay for that extra import?

Either we get more foreign investment (FDI & FII) and pay via that or we borrow from foreign banks (ECB) or we will have to dip into our external reserves to pay for that amount and in the process our forex reserves come down. When forex reserves come down below a critical level, country appears on the brink of BoP crisis.

So, is CAD such a bad thing?

Depends on what you do with those extra imports and how you finance the deficit! CAD is bad because:

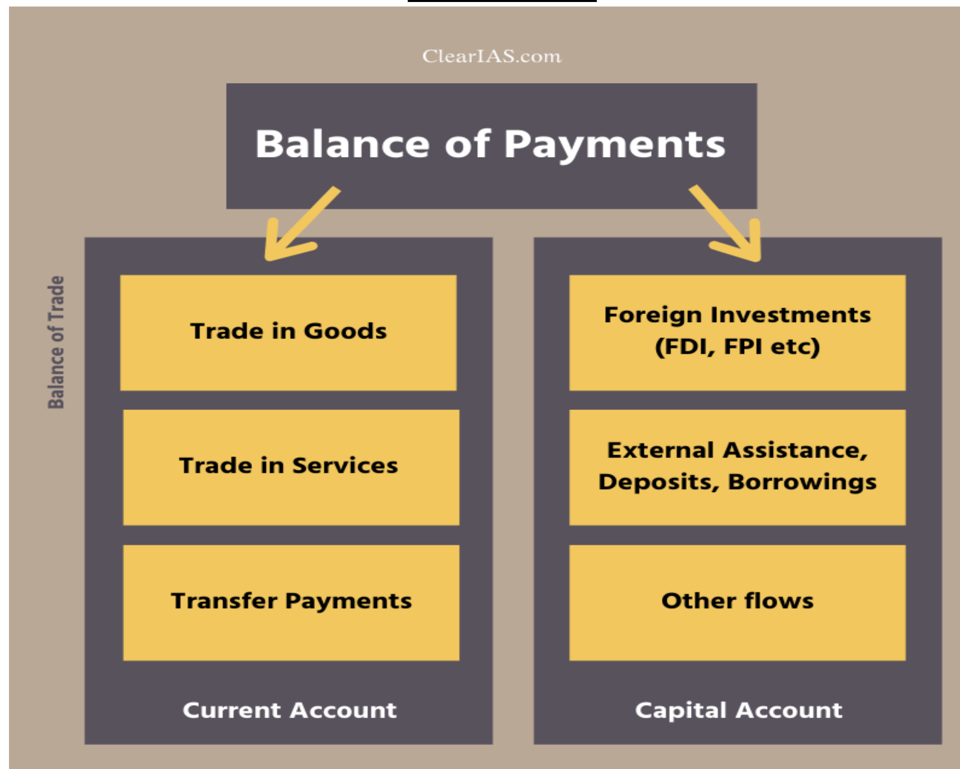
- If a CAD is financed through borrowing, it is unsustainable because borrowing lead to high interest payments in the future.
- Attracting capital flows (hot money, FII) to finance the deficit is risky as when confidence falls, hot money flows dry up, leading to a rapid devaluation and crisis of confidence. Eg. East Asian Crisis.

Run a CAD necessarily means running a surplus on the capital account. This means foreigners have an increasing claim on your assets, which they could redeem any time.

However a current account deficit is not necessarily harmful

CAD during a period of inward investment particularly stable long term FDI may not be a bad things as investment can create jobs. Investments will lead to higher growth will be able to pay debts back.
Developing countries may use CAD to buy Capital goods and later export consumer goods and thus repay the debt.
Moderate current account deficit (2% of GDP) financed mainly by stable foreign investments which creates jobs and infrastructure in the economy can be helpful in the long run as it improves productivity.

BOT VS BOP



- The balance of Trade (BoT) or Trade Balance is a part of the Balance of Payments (BoP). BoT just includes the balance between export and import of goods.
- BoP not only adds the service-trade but also many other components in the current account (Eg: Transfer payments) and capital account (FDI, loans etc).

Disequilibrium in Balance of Payments:Types,Causes

A country's balance of payment can be favourable or unfavourable.If there is a trade surplus and net inflow of capital the balance of payments would be favourable and show a surplus. Surplus in balance of payments is an indicator of soundness of the economy.
If,on the other hand,there is trade deficit and net capital outflow from the economy,the balance of payments is unfavourable and there is a deficit in the balance of payments.Both surplus and deficit are disequilibrium in balance of payments which arise out of certain factors.

Types of disequilibrium

- **Cyclical disequilibrium**
  Disequilibrium in balance of payments caused by the ups and downs of business cycles is called cyclical disequilibrium.
- Secular disequilibrium
  When balance of payments deficit or surplus is long term,it is called secular disequilibrium.
- Structural disequilibrium
  Such disequilibrium is caused due to changes in the international demand or supply of a product or changes in the institutions of the economy

Factors responsible for disequilibrium in Balance of Payments

1.Trade Cycles:

Cyclical fluctuations, their phases and amplitudes, differences in different countries, generally produce cyclical disequilibrium.

2. Huge Developmental and Investment Programmes:

Huge development and investment programmes in the developing economies are the root causes of the disequilibrium in the balance of payments of these countries. Their propensity to import goes on increasing for want of capital for rapid industrialisation; while exports may not be boosted up to that extent as these is the primary producing countries.

Moreover, their exports quantum of primary commodities may decline as newly-created domestic industries may require them. Thus, there will be structural changes in the balance of payments and structural disequilibrium will result.

3. Changing Export Demand:

A vast increase in the domestic production of foodstuffs, raw materials, substitute goods, etc. in advanced countries has decreased their need for import from the agrarian underdeveloped countries. Thus, export demand has considerably changed, resulting in structural disequilibrium in these countries.

Similarly, advanced countries also will suffer in their exports as a result of loss of their markets in developing countries owing to the tendency of the poor nations for self-reliance and their ways and means of curtailing their imports. But disequilibrium (deficit) in balance of payments seems to be more persistent in the underdeveloped or developing nations than in the advanced rich nations.

4. Population Growth:

High population growth in poor countries also had adversely affected their balance of payments position. It is easy to see that an increase in population increases the needs of these countries for imports and decreases the capacity to export.

5. Huge External Borrowings:

Another reason for a surplus or deficit in the balance of payments arises out of international borrowing and investment. A country may tend to have an adverse balance of payments when it borrows heavily from another country, while the lending country will tend to have a favourable balance and the receiving country will have a deficit balance of payments.

6. Inflation:

Owing to rapid economic development, the resulting income and price effects will adversely affect the balance of payments position of a developing country. With an income, the marginal propensity to import being high in these countries, their demand for imported articles will rise. Since marginal propensity to consume is also high in these countries, people's demand for domestic goods also will rise, and hence less may be spared for export. Moreover, a huge investment in heavy industries in the developing countries may have an inflationary impact, as the output of these industries will not be forthcoming immediately, whereas money income will have been already expanded.

Thus, there will be an excess of monetary demand for goods and services in general which will push up the price levels. A rise in the comparative price level certainly encourages imports and discourages exports, resulting in a deficit balance of payments.

7. Demonstration Effect:

Demonstration effect is another most important factor causing deficit in the balance of payments of a country — especially of an underdeveloped country. When people of underdeveloped nations come into contact with those of advanced countries through economic, political or social relations, there will be a demonstration effect on the consumption pattern of these people and they will desire to have western style goods and pattern of consumption so that their propensity to import increases, whereas their export quantum may remain the same or may even decline

8. Reciprocal Demands:
Since intensity of reciprocal demand for products of different countries differs, terms of trade of a country may be set differently with different countries under multi-trade transactions which may lead to disequilibrium in a way.

Measures to correct disequilibrium in the Balance of payments.

1. Monetary Policy (Deflection)

Monetary policy may be devised **to correct a deficit in the balance of payments of a country**. The deficit occurs because of high import and exports. This is to be reversed.

In this regard, the country may adopt deflationary or dear money policy by raising the bank rate and restricting credit

Under deflation, prices fall which makes exports attractive and imports relatively costlier.
This eventually leads to a rise in exports and a fall in imports.
The policy of money contraction or deflection keeps exchange rates unaffected and tries to correct the deficit in the Balance of payments through domestic changes.

However, deflation being in inexpedient, its Side Effects are dangerous to a poor Nation. It creates more unemployment and poverty.
Again a developing economy has to adopt an expansionary rather than a contraceptive monetary policy to cater to developmental needs.

2. Exchange Depreciation

Exchange depreciation means the decline in the rate of exchange of one country in terms of another.

For example – Assume- the Indian rupee exchanges for 65 Roubles of the Russian currency. If India experiences an adverse Balance of payments with regard to Russia, the Indian demand for Rouble will be rise.

Consequently, the price of Rouble in terms of Rupee will be appreciated in its external value.

Thus, the rate of exchange of Indian rupee in terms of rouble may change to 1 Rupee = 45 Roubles from 1 equal 45 balls this is known as 1 Rupee = 64 Roubles. This is known as Exchange Depreciation.
It is automatic and it helps in correcting a mild adverse Balance of payments.
This stimulates exports by making the domestic goods cheaper to the foreigners and thereby leading to favorable balance **However**, this method is not feasible under the present system of IMF which prescribes the fixed exchange rate system.

3. Devaluation

Devaluation of currency is another way that makes exports attractive.
The term Devaluation means a reduction in the official rate at which one currency is exchanged for another.
It is an alternative to exchange depreciation.
Devaluation is undertaken when the currency is found to be unduly overvalued.
evaluation makes the Goods cheaper for foreigners. Exports will rise and imports decline.

1. It takes considerable time to yield expected results.
2. Its effect is strongly purgative I.e. violent.

4. Exchange Control

Restriction on the use of foreign exchange by the central banks called **Exchange Control**.
When exchange control is adopted, all the exporters have to surrender their foreign exchange earnings to Central Bank.
Under exchange control, the central bank releases foreign exchanges only for essential imports and conserves the rest of the balance.
This is the most direct method of curbing imports.
Exchange control, in General, deals with the **balance of payments disequilibrium** by suppressing the deficit that is only a symptom and not the Basic Trouble.

In other words, exchange control can prevent a complete breakdown, but it cannot eliminate a condition of disequilibrium.

Thus, exchange control offers no permanent solution to the problem of persistent disequilibrium.

It can, at best be justified only as a temporary measure, to gain time while other more fundamental adjustments made to restore equilibrium in the Balance of payments.

5. Fiscal Policy- Import Duties

Under this policy, import traffic tariff duties are imposed so as to make the import dearer with an overall aim of checking imports.

Imports get reduced and **Balance of payments** becomes favorable.

6. Import Policy (Import Quotes)

Under this mechanism, the government fixes a maximum quantity or value of a commodity to be imported.

This in turn reduces and the deficit is reduced and thereby the Balance of payments, the position is improved.

This measure has the immediate effect of checking imports as the marginal propensity to import becomes zero once the quota limit is reached.

To **correct disequilibrium in Balance of payments** import quotes are assumed to be better than import duties.

The quota has the immediate effect of restricting imports as the marginal prosperity to import become zero, once the quota-limited is reached.

Thus, the effect of quotas on quantitative restriction (QR) of imports is explicit. But the Balance of payments effects of import duties and not to certain.

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7. Stimulating/Improving Export

To *correct disequilibrium in the Balance of payments*, it is necessary that exports should be increased, the government may adopt export programs for this purpose.

Export promotion programs include subsidies, tax concession to exporters, marketing facilities, incentives for exporters, reducing export duties, etc.

Further, to encourage exports the level of costs in the country may have to be brought down.

Thus, may involve cutting down on wages and interest rates and other incomes and also a contraction of currency to bring the prices down.

8. Foreign Loans

The government can also secure loans from foreign banks or foreign governments to reduce the deficit in the balance of payments.

Since the repayment of these loans is spread over a long period, This helps the government to remove the deficit in the Balance of payments.

During the currency of the loans, the government takes steps to improve its foreign exchange position.

9. Encouragement to Foreign Investment

The government induces the foreigners to make an investment in the country offering them all sorts of investors incentives and concessions.

This provides the government with extra foreign exchanges which are utilized to reduce the deficit in the Balance of payments.

But while inviting the foreign capitalist to invest their capital within the country, the government sees to it that this does not produce any adverse repercussions on the economy.

10. Incentives to Foreign Tourist

The government may also encourage foreign tourists to visit the country in increasing numbers of offering them various facilities and constitutional travel.

This increases the foreign exchange earnings of the country with the help of which the deficit in the Balance of payments can be reduced.

11. Automatic Measures

The *disequilibrium in the balance of payments* may automatically disappear after sometime when certain forces came into operation in the country.

For example – The disequilibrium in the Balance of payments of a country under the gold standard was automatically corrected through the inflow and outflow of gold.

If the balance of payments was unfavorable there was an outflow of gold from the country causing a contraction in the volume of currency and credit, and ultimately a fall in the domestic price level. This encouraged exports, while it discouraged imports. The equilibrium in the BOP was automatically restored after some time.

Similarly, the **equilibrium in the Balance of payments** of a country on the paper standard was automatically corrected through fluctuations in its rate of exchange.

For example – If the country's BOP was unfavorable, the demand for foreign exchange exceeded its supply, and consequently, the exchange value of its currency went down. The fall in its exchange value encouraged exports while it discouraged imports.

The Equilibrium in the **BOP** was automatically restored after the lapse of some time. The opposite process worked when the Balance of payments of the nation turned favorable.

The automatic measures discussed above did not produce the desired results in a short period. Nor were they effective in dealing with a serious and fundamental disequilibrium in the BOP.

12. Miscellaneous Measures

These include- developing import-substituting Industries, postponing debt payments, check on inflation, check on smuggling, etc. All these may help in **correcting disequilibrium in the Balance of payments**.

To Sum up, some of the deficit in the balance of payments is not a desirable phenomenon for a nation.

The methods mentioned above aim at reducing imports and stimulating exports.

Of these, The trade measures are better and effective. It produces immediate results

UNIT III

GLOBAL ENTRY

International business may be defined simply as business transactions that take place across national borders.This broad definition includes the very small firm that exports (or imports) a small quantity to only one country, as well as the very large global firm with integrated operations and strategic alliances around the world.

Within this broad array, distinctions are often made among different types of international firms, and these distinctions are helpful in understanding a firm's strategy, organization, and functional decisions (for example, its financial, administrative, marketing, human resource, or operations decisions).

International strategic management builds on five phases of planning and analysis that provide a framework for deploying resources and a plan of action.

- Recognizing antecedents
- External and internal analysis
- Strategic analysis and choice
- Leveraging competitive advantage and process
- Implementation and integration

STRATEGIC COMPULSIONS:

It means that the companies face the compulsion to be global if they want to gain the global market and more values. But in the modern context strategic management faces many compulsions. The present and future development of the field of strategic management is likely to be driven by compulsions like contemporary developments in social and economic theory and recent changes in the nature of the business and economic context.

International/global strategic management

Strategic management is the process of systematically analyzing various opportunities and threats vis-à-vis organizational strengths and weaknesses, formulating and arriving at strategic choices through critical evaluation of alternatives and implementing them to meet the set objectives of the organization.

Area of strategic compulsions

- Orientation for globalization
- Emerging E-commerce and Internet culture
- Cut-throat competition
- Diversification
- Active pressure groups
- Motive for corporate social responsibility (CSR) and ethics.

STANDARDIZATION VERSUS DIFFERENTIATION:

According to Levitt, represents local marketing versus global marketing and focus on the central question of whether a standardized (global) or a differentiated (local), country-specific marketing approach.

Perspectives on standardization versus Differentiation:

- Regional perspective
- Marketing process prospective
- Marketing components/marketing mix perspective.

Micheal Porter's Generic Strategies

1. **Cost Leadership**

- Cost leadership means having the lowest per-unit (i.e., average) cost in the industry – that is, lowest cost relative to your rivals.
- This could mean having the lowest per-unit cost among rivals in highly competitive industries, in which case returns or profits will be low but nonetheless higher than competitors
- Or, this could mean having lowest cost among a few rivals where each firm enjoys pricing power and high profits.
- Notice that cost leadership is defined independently of market structure.

Cost leadership is a defendable strategy because:

- It defends the firm against powerful buyers. Buyers can drive price down only to the level of the next most efficient producer.
- It defends against powerful suppliers. Cost leadership provides flexibility to absorb an increase in input costs, whereas competitors may not have this flexibility.
- The factors that lead to cost leadership also provide entry barriers in many instances. Economies of scale require potential rivals to enter the industry with substantial capacity to produce, and this means the cost of entry may be prohibitive to many potential competitors.

Achieving a low cost position usually requires the following resources and skills:

- Large up-front capital investment in new technology, which hopefully leads to large market share in the long-run, but may lead to losses in the short-run.
- Continued capital investment to maintain cost advantage through economies of scale and market share.
- Process innovation – developing cheaper ways to produce existing products.
- Intensive monitoring of labor, where workers frequently have an incentive-based pay structure (i.e., a contract which includes some combination of a fixed-wage plus piece- rate pay).
- Tight control of overhead.

2. Differentiation

- Differentiating the product offering of a firm means creating something that is perceived industry wide as being unique.
- It is a means of creating your own market to some extent.
- There are several approaches to differentiation: o Different design o Brand image
  o Number of features o New technology
- A differentiation strategy may mean differentiating along 2 or more of these dimensions.

Differentiation is a defendable strategy for earning above average returns because:

- It insulates a firm from competitive rivalry by creating brand loyalty; it lowers the price elasticity of demand by making customers less sensitive to price changes in your products.
- Uniqueness, almost by definition, creates barriers and reduces substitutes. This leads to higher margins, which reduces the need for a low-cost advantage.
- Higher margins give the firm room to deal with powerful suppliers.
- Differentiation also mitigates buyer power since buyers now have fewer alternatives.

Achieving a successful strategy of differentiation usually requires the following:

- Exclusivity, which unfortunately also precludes market share and low cost advantage.
- Strong marketing skills.
- Product innovation as opposed to process innovation.
- Applied R&D.
- Customer support.
- Less emphasis on incentive based pay structure.

1 Focus or Niche Strategy

- Here we focus on a particular buyer group, product segment, or geographical market.
- Whereas low cost and differentiation are aimed at achieving their objectives industry wide, the focus or niche strategy is built on serving a particular target (customer, product, or location) very well.
- Note, however, that a focus strategy means achieving either a low cost advantage or differentiation in a narrow part of the market. For reasons discussed above, this creates a defendable position within that part of the market.

Stuck in the Middle:

- Failure to develop a strategy in one of these 3 directions is a firm that is "stuck in the middle."
- This means you lack the market share, capital, and overhead control to be a cost leader, and lack the industry wide differentiation necessary to create margins which obviate the need for a low-cost position.
- Being "stuck" implies low profits as a rule: profits are bid away to compete with low cost producers; or, the firm loses high margin business to firms who achieve better differentiation.
- Classic examples of this problem are large, international airline companies, many of which are now bankrupt.
- Depending on a firm's capabilities and resources, a "stuck" firm must gravitate toward either low cost (usually by buying market share) or focus or differentiation (which may mean decreasing market share).

Risks of each Strategy:

Each generic strategy is based on erecting different kinds of defences against the competitive forces, and hence they involve different risks.

Cost Leadership:

Maintaining cost leadership can be risky because:

- Innovations nullify past inventions and learning, and hence cost leadership requires continual capital investment to maintain cost advantage.
- Exclusive attention to cost can blind firms to changes in product requirements.
- Cost increases narrow price differentials and reduce ability to compete with competitors' brand loyalty.

- Differentiation:
  - Risks are:
    - Cost differentiation between low cost firms and differentiating firms becomes too large to hold customer loyalty. Buyers trade-off features, service, or image for price.
    - Buyers need for differentiation falls.
    - Imitation decreases perceived differentiation.

STRATEGIC OPTIONS:

Strategic options/choice involves the selection of a strategy or set of strategies that helps in achieving organizational objectives.

1. Global strategy
2. International strategy
3. Transactional strategy
4. Multi-domestic strategy

1. Global strategy: It views the world as a single market. Tightly controls global operations from headquarters to preserve focus on standardization.

2. International strategy: In this strategy company extends marketing, manufacturing and other activities outside the home country.

3. Multi-domestic strategy: the international company discovers that differences in markets around the world demand an adaptation of its marketing mix in order to succeed.

4. Transactional strategy: this is company that thinks globally and acts locally. The transactional corporation is much more than a company with sales, investments and operations in many countries.

Factors affecting strategic options:

1) External constraints
2) Intra-organizational forces and managerial power-relations
3) Values and preferences and managerial attitudes risk
4) Impact of past strategy
5) Time constraints in choice of strategy.
6) Information constraints
7) Competitor's reaction

GLOBAL PORTFOLIO MANAGEMENT:

Global portfolio investment means the purchase of stocks, bonds, and money market instruments by foreigners for the purpose of realizing a financial return which does not result in foreign management, ownership, or control. Portfolio investment is part of the capital account on the balance of payments statistics. An international portfolio is designed to give the investor exposure to growth in emerging and international markets and provide diversification.

Factors affecting global portfolio investment:

1) Tax rates on interest or dividends
2) Interest rates
3) Exchange rates

Problems of global portfolio investment:

1. Unfavorable exchange rate movement
2. Frictions in international financial market
3. Manipulation of security prices
4. Unequal access to information

GLOBAL ENTRY STRATEGIES:

Level of involvement:

- Wholly-owned subsidiary
- Company acquisition
- Assembly operations
- Joint venture
- Strategic alliance
- Licensing
- Contract manufacture
- Direct marketing
- Distributors and agents
- Sales force
- Trading companies
- Export management companies
- Piggyback operations
- Domestic purchasing
- Franchising

FORMS OF INTERNATIONAL BUSINESS:

I) Exporting as an entry strategy:

Exporting is the most traditional mode of entering the foreign market. Exporting is that which allows manufacturing operations to be concentrated in a single location, which may lead to scale economics. Exporting is a typically the easiest way to enter an international market, and therefore most firms begin their international expansion using this model of entry. Exporting is the sale of products and services in foreign countries that are sourced from the home country. The advantage of this mode of entry is that firms avoid the expense of establishing operations in the new country. Firms must, however, have a way to distribute and market their products in the new country, which they typically do through contractual agreements with a local company or distributor. When exporting, the firm must give thought to labeling, packaging, and pricing the offering appropriately for the market. In terms of marketing and promotion, the firm will need to let potential buyers know of its offerings, be it through advertising, trade shows, or a local sales force.

a) Indirect exporting: For firms that little inclination or few resources for international marketing, the simplest and lowest cost method of market entry is for them to have their products sold overseas by others

b) Direct exporting:

Exporting is the most popular approach for firms as it requires fewer resources, has little effect on existing operation and involves low investment and financial risks.

II) Manufacturing strategies without foreign direct investment:

1) Licensing:

Under a licensing agreement, a company (the licensor) grants rights to intangible property to another company (the licensee) for a specified period; in exchange, the licensee ordinarily pays a royalty to the licensor. Licensing is a common method of international market entry for companies with a distinctive and legally protected asset, which is a key differentiating element in their marketing offer. It involves a contractual arrangement whereby a company licenses the rights to certain technological know-how, design, patents, trademarks and intellectual property to a foreign company in return for royalties or other kinds of payment. For example, Disney's mode of entry in Japan had been licensing.Because little investment on the part of the licensor is required, licensing has the potential to provide a very large ROI. However, because the licensee produces and markets the product, potential returns from manufacturing and marketing activities may be lost.

2) Franchising:

It means of marketing goods and services in which the franchiser grants the legal right to use branding, trademarks and products and the method of operation is transferred to third party – the franchise – in return for a franchise fee.

3) Contract manufacture:

A firm which markets and sells products into international markets might arrange for a local manufacturer to produce the product for them under contract.

4) Turnkey projects:

It is a contract under which a firm agrees to fully design, construct and equip a manufacturing/business/service facility and turn the project over to the purchaser when it is ready for operation for remuneration.

5) Managements contracts:

It is an agreement between two companies, whereby one company provides managerial assistance, technical expertise and specialized services to the second company of the argument for a certain agreed period in return for monetary compensation

III) Manufacturing strategies with FDI:

1) Joint ventures:

It occurs when a company decides that shared ownership of a specially set up new company for marketing and/or manufacturing is the most appropriate method of exploiting a business opportunity.

2) Strategic alliances:

SIA is a business relationship established by two or companies to co-operate out of mutual need and to share risk in achieving a common objective. A strategic alliance involves a contractual agreement between two or more enterprises stipulating that the involved parties will cooperate in a certain way for a certain time to achieve a common purpose. To determine if the alliance approach is suitable for the firm, the firm must decide what value the partner could bring to the venture in terms of both tangible and intangible aspects. The advantages of partnering with a local firm are that the local firm likely understands the local culture, market, and ways of doing business better than an outside firm. Partners are especially valuable if they have a recognized, reputable brand name in the country or have existing relationships with customers that the firm

access. For example, Cisco formed a strategic alliance with Fujitsu to develop routers for Japan. In the alliance, Cisco decided to co-brand with the Fujitsu name so that it could leverage Fujitsu's reputation in Japan for IT equipment and solutions while still retaining the Cisco name to benefit from Cisco's global reputation for switches and routers.

3) Merger:

It is a combination (other terms are amalgamation, consolidation or integration) of two or More organizations in which one acquires the assets and liabilities of the other in exchange for shares or cash.

4) Acquisition:

It is process of acquiring and purchasing an existing venture. It is one of the easy means of expanding a business by entering new markets or new product areas. An acquisition is a transaction in which a firm gains control of another firm by purchasing its stock, exchanging the stock for its own, or, in the case of a private firm, paying the owners a purchase price. In recent years, cross- border acquisitions have made up over 60 percent of all acquisitions completed worldwide. Acquisitions are appealing because they give the company quick, established access to a new market. However, they are expensive, which in the past had put them out of reach as a strategy for companies in the undeveloped world to pursue. The higher interest rates in developing nations has strengthened their currencies relative to the dollar or euro. If the acquiring firm is in a country with a strong currency, the acquisition is comparatively cheaper to make.

5) wholly-owned subsidiary:

The common reason for operating wholly-owned subsidiary separately from the owner company could be name value. Often, a well-known and respected corporation is acquired by another entity that has no name recognition in that particular market. The process of establishing of a new, wholly owned subsidiary (also called a green field venture) is often complex and potentially costly, but it affords the firm maximum control and has the most potential to provide above-average returns. The costs and risks are high given the costs of establishing a new business operation in a new country. The firm may have to acquire the knowledge and expertise of the existing market by hiring either host-country nationals—possibly from competitive firms—or costly consultants.

6) Assembly operations:

A foreign owned operation might be set up simply to assemble components which have been manufactured in the domestic market. It has the advantage of reducing the effect of tariff barriers which are normally lower on components than on finished goods.
Increased investment opportunities: with globalization companies can move capital to whatever country offers the most attractive investment opportunity. This prevents capital being trapped in domestic economies earning poor returns.

Factors affecting the selection of entry mode

External factors

1) Market size
2) Market growth
3) Government regulations
4) Level of competition
5) Level of risk

Internal factors

1) Company objectives
2) Availability of company resources
3) Level of commitment
4) International experience
5) Flexibility

Advantage and Organizational Issues in International Business

Advantage of International Business

- **Earning valuable foreign currency:** A country is able to earn valuable foreign currency by exporting its goods to other countries.
- **Division of labor:** International business leads to specialization in the production of goods. Thus, quality goods for which it has maximum advantage.
- **Optimum utilization of available resources:** International business reduces waste of national resources. It helps each country to make optimum use of its natural resources. Every country produces those goods for which it has maximum advantage.
- **Increase in the standard of living of people:** Sale of surplus production of one country to another country leads to increase in the incomes and savings of the people of the former country. This raises the standard of living of the people of the exporting country.
- **Benefits to consumers:** Consumers are also benefited from international business. A variety of goods of better quality is available to them at reasonable prices. Hence, consumers of importing countries are benefited as they have a good scope of choice of products.
- **Encouragement to industrialization:** Exchange of technological know-how enables underdeveloped and developing countries to establish new industries with the assistance of foreign aid. Thus, international business helps in the development of industry.
- **International peace and harmony:** International business removes rivalry between different countries and promotes international peace and harmony. It creates dependence on each other, improves mutual confidence and good faith.
- **Cultural development:** International business fosters exchange of culture and ideas between countries having greater diversities. A better way of life, dress, food, etc. can be adopted form other countries.
- **Economies of large-scale production:** International business leads to production on a large scale because of extensive demand. All the countries of the world can obtain the advantages of large-scale production.
- **Stability in prices of products:** International business irons out wide fluctuations in the prices of products. It leads to stabilization of prices of products throughout the world.
- **Widening the market for products:** International business widens the market for products all over the world. With the increase in the scale of operation, the profit of the business increases.
- **Advantageous in emergencies:** International business enables us to face emergencies. In case of natural calamity, goods can be imported to meet necessaries.
- **Creating employment opportunities:** International business boosts employment opportunities in an export-oriented market. It raises the standard of living of the countries dealing international business.
- **Increase in Government revenue:** The Government imposes import and export duties for this trade. Thus, Government is able to earn a great deal of revenue from international business.
- **Other advantages:** Effective business education, Improvement in production systems, Elimination of monopolies, etc

Disadvantage of International Business

- **Adverse effects on economy:** One country affects the economy of another country through international business. Moreover, large-scale exports discourage the industrial development of importing country. Consequently, the economy of the importing country suffers.
- **Competition with developed countries:** Developing countries are unable to compete with developed countries. It hampers the growth and development of developing countries, unless international business is controlled.
- **Rivalry among nations:** Intense competition and eagerness to export more commodities

may lead rivalry among nations. As a consequence, international peace may be hampered.

- **Colonization:** Sometimes, the importing country is reduced to a colony due to economic and political dependence and industrial backwardness.
- **Exploitation:** International business leads to exploitation of developing countries the developed countries. The prosperous and dominant countries regulate the economy poor nations.
- **Legal problems:** Varied laws regulations and customs formalities followed different countries, have a direct b earring on their export and import trade.
- **Publicity of undesirable fashions:** Cultural values and heritages are not identical in all the countries. There are many aspects, which may not be suitable for our atmosphere, culture, tradition, etc. This, indecency is often found to be created in the name of cultural exchange.
- **Language problems:** Different languages in different countries create barriers to establish trade relations between various countries.
- **Dumping policy:** Developed countries often sell their products to developing countries below the cost of production. As a result, industries in developing countries of the close down.
- **Complicated technical procedure:** International business in highly technical and it has complicated procedure. It involves various uses of important documents. It required expert services to cope with complicate procedures at different stages.
- **Shortage of goods in the exporting country:** Sometimes, traders prefer to sell their goods to other countries instate of in their own country in order to earn more profits. This results in
  the shortage of goods within the home country.
- **Adverse effects on home industry:** International business poses a threat to the survival of infant and nascent industries. Due to foreign competition and unrestricted imports upcoming industries in the home country may collapse.

ORGANIZATIONAL STRUCTURE

An **organizational structure** defines how activities such as task allocation, coordination and supervision are directed towards the achievement of organizational aims. It can also be considered as the viewing glass or perspective through which individuals see their organization and its environment. Organizations are a variant of clustered entities.
An organization can be structured in many different ways, depending on their objectives. The structure of an organization will determine the modes in which it operates and performs. Organizational structure allows the expressed allocation of responsibilities for different functions and processes to different entities such as
the branch, department, workgroup and individual. It affects organizational action in two big ways. First, it provides the foundation on which standard operating procedures and routines rest. Second, it determines which individuals get to participate in which decision-making processes, and thus to what extent their views shape the organization's actions

Designing organizational structure: It includes an analysis of the following aspects;

1) External environment
2) Overall aims and purpose of the enterprise
3) Objectives
4) Activities
5) Decisions
6) Relationships
7) Organization structure
8) Job structure
9) Organization climate

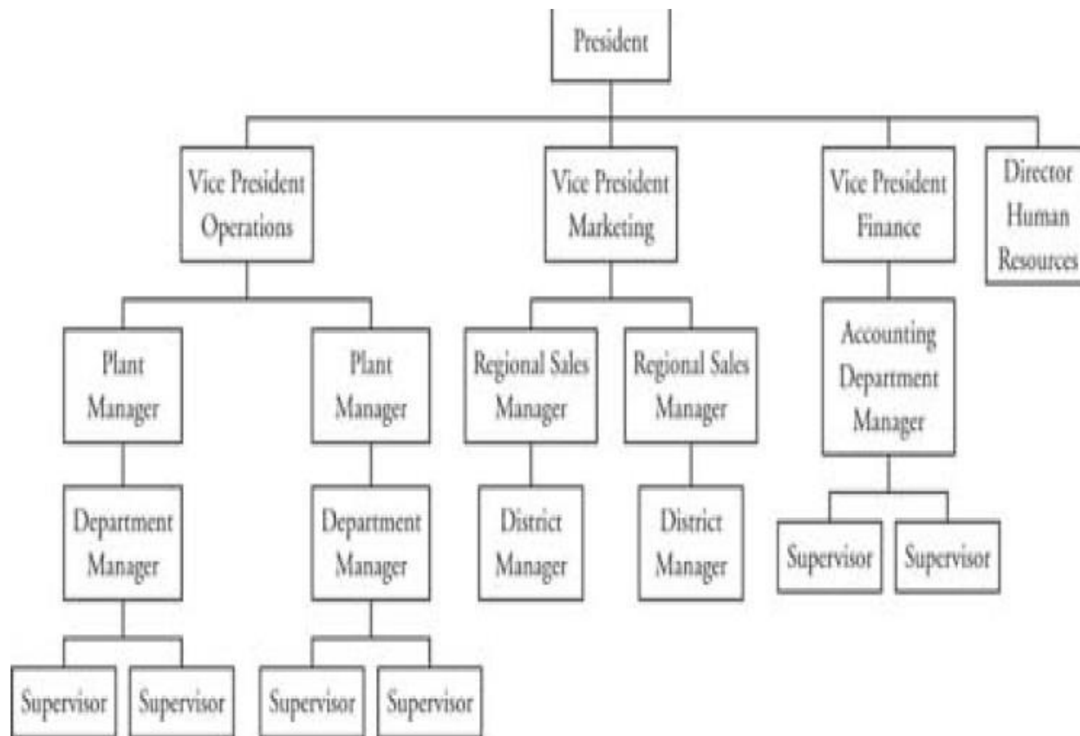
Types of organizational structure

1) International division's structure:
Grouping each international business activity into its own division, puts internationally specialized personnel together to handle such diverse matters as export documentation, foreign exchange transactions and relations with foreign governments.

Advantages of Divisional Organizational Structure
Divisions work well because they allow a team to focus upon a single product or service, with a leadership structure that supports its major strategic objectives. Having its own president or vice president makes it more likely the division will receive the resources it needs from the company. Also, a division's focus allows it to build a common culture and *esprit de corps* that contributes both to higher morale and a better knowledge of the division's portfolio. This is far preferable to having its product or service dispersed among multiple departments through the organization.

Disadvantages of Divisional Organizational Structure
A company comprised of competing divisions may allow office politics instead of sound strategic thinking to affect its view on such matters as allocation of company resources. Thus, one division will sometimes act to undermine another.
Also, divisions can bring compartmentalization that can lead to incompatibilities. For example, Microsoft's business-software division developed the Social Connector in Microsoft Office Outlook 2010. They were unable to integrate

2) Functional division's structure:
It emphasizes on specific functions such as manufacturing, marketing, finance and so on. It is more suitable where the products and customers are few and homogeneous.

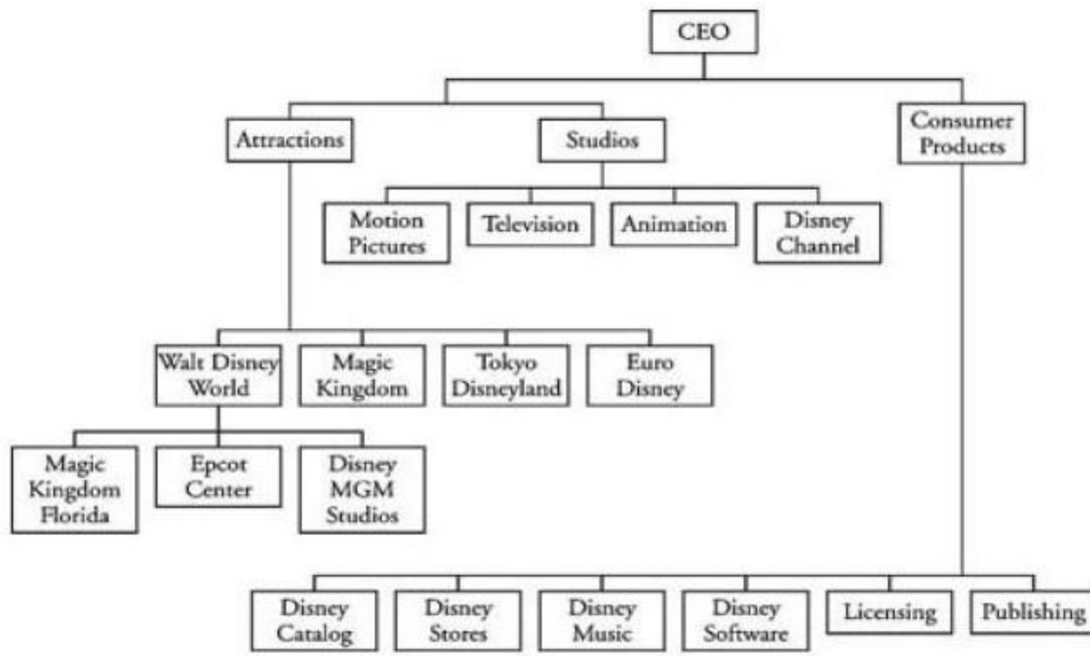


A functional structure features well-defined channels of communication and authority/responsibility relationships. Not only can this structure improve productivity by minimizing duplication of personnel and equipment, but it also makes employees comfortable and simplifies training as well. But the functional structure has many downsides that may make it inappropriate for some organizations. Here are a few examples:

- The functional structure can result in narrowed perspectives because of the separateness of different department work groups. Managers may have a hard time relating to marketing, for example, which is often in an entirely different grouping. As a result, anticipating or reacting to changing consumer needs may be difficult. In addition, reduced cooperation and communication may occur.
- Decisions and communication are slow to take place because of the many layers of hierarchy. Authority is more centralized.
- The functional structure gives managers experience in only one fields their own. Managers do not have the opportunity to see how all the firm's departments work together and understand their interrelationships and interdependence. In the long run, this specialization results in executives with narrow backgrounds and little training handling top management duties.

3) Product division structure:

It is more common in international business and more suitable in case of a multiple brand system. In this case, there are different product divisions, in each division, there are subdivisions.



Examples include departments created to distinguish among production, customer service, and geographical categories. This grouping of departments is called divisional structure. These departments allow managers to better focus their resources and results. Divisional structure also makes performance easier to monitor. As a result, this structure is flexible and responsive to change. However, divisional structure does have its drawbacks. Because managers are so specialized, they may waste time duplicating each other's activities and resources. In addition, competition among divisions may develop due to limited resources.

4) Geographic (Area) division structure:

In case of area structure, organization is based on the geographic areas, namely, Asia, Africa, and Latin America and so on and the operation is divided accordingly.

Advantages of a geographical structure

A geographical structure can offer several operational and strategic advantages, including:

- close communication with local customers
- strong collaborative teams at each location
- the ability to better serve local needs and tailor their approach to the local market
- the ability to encourage positive competition between different departments

It makes sense to divide an organisation by region if **different cultures, rules, languages** and **customer preferences** exist in the area where the business operates. Logistics relating to shipping, resources and staff also sometimes make the geographical structure a good choice.

Disadvantages

The main downside of a geographical organisational structure is the potential conflict between local and central management, as individual divisions often take on a great deal of autonomy. Other disadvantages include:

- potential duplication of jobs, resources and functions
- some economies of scale may be lost

5) Matrix division structure:

The global matrix structure is more complex when it combines all the three aspects – product, area, and function. This is found in multi-product firms where one group of products needs area structure of organization, while the other group of products needs functional structure, and for yet another group, product structure is found more appropriate.

Advantages

This structure not only increases employee motivation, but it also allows technical and general management training across functional areas as well. Potential advantages include

- Better cooperation and problem solving.
- Increased flexibility.
- Better customer service.
- Better performance accountability.
- Improved strategic management.

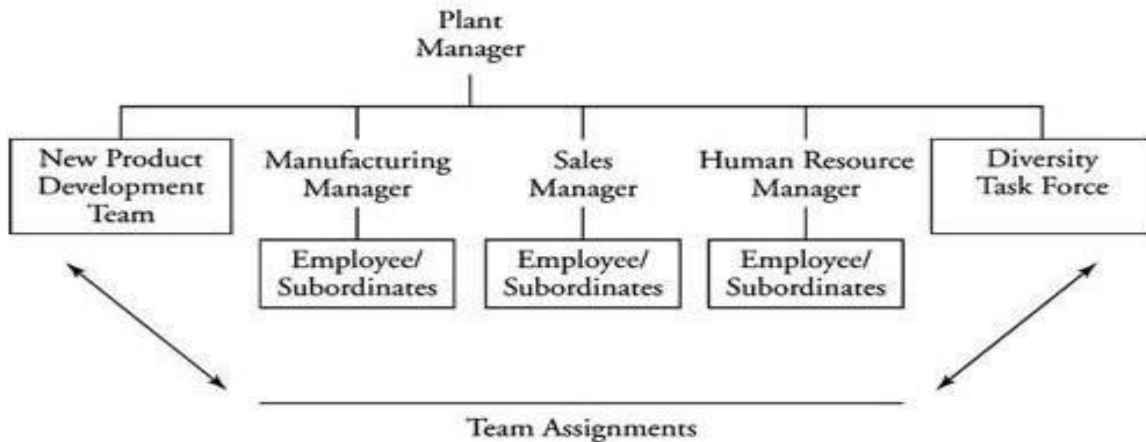
Disadvantages.

The two-boss system is susceptible to power struggles, as functional supervisors and team leaders vie with one another to exercise authority.

- Members of the matrix may suffer task confusion when taking orders from more than one boss.
- Teams may develop strong team loyalties that cause a loss of focus on larger organization goals.
- Adding the team leaders, a crucial component, to a matrix structure can result in increased costs.

6) Team structure:

Team structure organizes separate functions into a group based on one overall objective (see Figure 4). These **cross functional teams** are composed of members from different departments who work together as needed to solve problems and explore opportunities. The intent is to break down functional barriers among departments and create a more effective relationship for solving ongoing problems.



The team structure has many potential advantages, including the following:

- Intradepartmental barriers break down.
- Decision-making and response times speed up.
- Employees are motivated.
- Levels of managers are eliminated.
- Administrative costs are lowered.

The disadvantages include:

- Conflicting loyalties among team members.
- Time-management issues.
- Increased time spent in meetings.

Managers must be aware that how well team members work together often depends on the quality of interpersonal relations, group dynamics, and their team management abilities.

7) Mixed structure:

Most firms allow the hybrid design which best suits their purpose as dictated by size, strategy, and technology, environment and culture. This is the reason why the famous saying "structure follows strategy has emerged. Ex: Philips and Unilever

CONTROLLING OF INTERNATIONAL BUSINESS

According to Child, "Control is essentially concerned with regulating the activities within an organization so that they are in accord with expectations established in policies, plans and Practices.

Levels

There are three main levels at which control can be implemented and managed in an international business. These three key levels of control are as follows:

1. Strategic
2. Organizational
3. Operational

Strategic Control:

Strategic control in intended both how well an international business formulates strategy and how well it goes about implementing it. Thus strategic control focuses on how well the firm defines and maintains its desired strategic alignment with its environment and how effectively it is setting and achieving its strategic goals.

Strategic control also play a major role in the decisions firms make about foreign-market entry and expansion and most critical aspect of strategic control is control of an international firm's financial resources.

Organizational Control:

Organizational control focuses on the design of the organization itself. There are many different forms of organizational design an international firm can use. But selecting and implementing a particular design does not necessarily end the organization design process.

International firm generally use one or more of three types of organizational control systems:

a. Responsibility Centre Control:

The most common type of organizational control system is a decentralized one called responsibility centre control. Using this system, a firm first identifies fundamentals responsibility centers within the organization. Strategic business units are frequently defined as responsibility centers, as are geographical regions or product groups.

b. Generic Organizational Control:

A firm may prefer to use generic organizational across its entire organization; that is, the control systems used are the same for each unit or operation, and the locus of authority generally resides at the firm's headquarters.

c. Planning Process Control:

A third type of organizational control, which could be used in combination with either responsibility center control or generic organizational control, focuses on the strategic planning process itself rather than on outcomes. Planning process control calls for a firm to concentrate its organizational control system on the actual mechanics and processes its uses to develop strategic plans.

Operations Control:

The third level of control in an international firm is operations control. Operations control focuses specifically on operating processes and systems within both the firm and its subsidiaries and operating units. Thus a firm needs an operation control system within each business unit and within each country or market in which it operates.

Types/Methods of control systems:

1) **Personal controls:** It is control by personal contact with subordinates.

2) **Bureaucratic controls:** The control through a system of rules and procedures that directs the actions of sub-units.

3) **Output controls:** It involves setting goals for subsidiaries to achieve; expressing these goals in terms of relatively objective criteria such as profitability, productivity, growth, market share, and quality.

4) **Cultural controls:** It exists when employees “buy into” the norms and value systems of the firm.

Approaches to control:
1) Market approach
2) Rules approach
3) Corporate culture approach

Control mechanisms:
1) Reports
2) Visits to subsidiaries
3) Management performance evaluations
4) Cost and comparisons
5) Evaluative measurements
6) Information systems

Process of performance measurement
- Establish standards of performance
- Measure actual performance
- Analyze performance and compare it with standards
- Construct and implement an action plan
- Review and revise standards

Performance evaluation system
It can be defined as, “the periodic review of operations to ensure that the objectives of the enterprise are being accomplished”.
Various performance indicators:
1) Financial measures
a) Return on investment(ROI)
b) Budget as a success indicator
2) Non-financial measures.
Types of performance evaluation system
1) Budget programming
2) Management audit
3) PERT(Program evaluation review technique)
4) Management information system

Establishing International Control Systems
Control systems in international business are established through four basic steps:
1. Set Control standards for performance
2. Measure actual performance
3. Compare performance against standards
4. Respond to deviations

- **Set Control Standards for Performance**

The first step in establishing an international control system is to define relevant control standards. A control standards in this context is a target, a desired level of performance component the firm is attempting control. Control standards need to be objective and consistent with firm’s goals. Suppose a firm is about to open its first manufacturing facility in Thailand. It might set the following three control standards for the plant:
a. Productivity and quality in the new plant will exceed the levels in the firm’s existing plants.
b. After an initial break-in period, 90% of all key management positions in the plant will be

filled by local managers.
c. The plant will obtain at least 89% of its resources from local suppliers.

- **Measure Actual Performance**

The second step in creating an international control system is to develop a valid measure of the performance component being controlled. For the firm introducing a new product in a foreign market, performance is based on the actual number of units sold. For the new plant in Thailand used as an example earlier, performance would be assessed in terms of productivity, quality, and hiring and purchasing practices.

- **Compare Performance Against Standards**

The next step in establishing an international control system is to compare measured performance against the original control standards. Again, when control standards are straightforward and objective and performance is relatively easy to asses, this comparison is easy. But when control standards and performance measures are less concrete, comparing one against the other is considerably more complicated.

- **Responding to Deviations**

The final step in establishing an international control system is responding to deviations observed in step 3. Three different outcomes can result when comparing a control standard and actual performance:
a. The control standard has been met.
b. It has not been met.
c. It has been exceeded.
Depending on the circumstances, managers have many alternative responses to these outcomes. If a standard has not been met and the manager believes it is because of performance deficiencies on the part of employees accountable for the performance, the manger may mandate higher performance, increase incentives to perform at a higher level, or discipline or even terminate those employees.

Essential Controlling Techniques

Because of the complexities of both the international environment and international firms themselves, those firms rely on a wide variety of different control techniques. We do not describe them all here but introduce a few of the most important ones.

1. Accounting Systems:

Accounting is a comprehensive for collecting, analyzing, and communicating data about firm's financial resources. Accounting procedures are heavily regulated and must follow prescribed methods dictated by national government. Because of these regulations and systems accounting process can be a good controlling techniques.

2. Procedures:

Firms also use various procedures to maintain effective control. Policies, standard operating procedures, rules, and regulations all help managers carry out the control function.

3. Performance Ratio:

International firms also use various performance rations to maintain control. A performance ratio is a numerical index of performance that the firm wants to maintain. A common performance ration used by many firms is inventory turnover. Holding excessive inventory is dysfunctional because the inventory ties up resources that could otherwise be used for different purposes and because the longer materials sit in inventory, the more prone they are to damage and loss.

Controlling Quality in International Business

Control also helps firms maintain and enhance the quality has become such a significant competitive issue in most industries that control strategies invariably have quality as a central focus. Quality is a vital importance for several reasons:

1. Many firms today compete on the basis of quality.
2. Quality is important because it is directly linked with productivity.
3. Higher quality helps firms to develop and maintain customer loyalty.

Quality consist of eight dimensions:

1. **Performance:** comprises the product's primary operating characteristics, such as, an automobile's ability to transport its driver.
2. **Features:** include supplementary characteristics, such a power window on an automobile.
3. **Reliability:** refers to the dependability of a product, such as the probability of an automobile's starting.
4. **Conformance:** is how well the product meets normal standards.
5. **Durability:** refers to the product's expected lifespan.
6. **Serviceability:** refers to how fast and easily the product can be repaired.
7. **Aesthetics:** refers to how the product looks, feels, tastes, and/or smells.
8. **Perceived quality:** is the level of quality as seen by the customer.

Quality Improvement Tools

1. **Statistical process control:** is a family of mathematically-based tools for monitoring and controlling quality. Its basic purpose is to define the target level of quality, specify an acceptable range of deviation, and then ensure that product quality is hitting the target.
2. **Benchmarking:** is the process of legally and ethically studying how other firms do something in high-quality way and then either imitating or improving on their methods.
3. **Total Quality Management (TQM):** is an integrated effort to systematically and continuously improve the quality of an organization's products and /or services. The components of TQM are – strategic commitment to quality, employee involvement, highquality materials, up-to-date technology, and effective process.

PERFORMANCE OF GLOBAL BUSINESS:

Global Business Performance is a flexible, web based solution that provides the key components to support global decision making. It offers the integration and management of multiple, cross-country data sources including POS, retailer direct, syndicated and consumer data. Global Business Performance identifies trends and opportunities and delivers sales and performance insights across regions, countries and categories, only days after data is available.

Business Issue Addressed:

Sales & Channel Management

Key Features and Benefits:

- Data from many disparate sources can be harmonized and integrated to give one consistent, accurate and actionable view of a company's performance across many different markets.
- Sales, trends, performance, issues and opportunities can be identified across multiple countries, regions and categories a few days after the data is available, rather than weeks or months later.

UNIT- 4

GLOBAL PRODUCTION STRATEGIES:

Multi-domestic**.** Concerns operations where each market is serviced independently.
Can relate to simple products that are easy to replicate but costly to transport over long distances. Production can be integrated globally, while the marketing is Multi-domestic, reflecting cultural and consumer preferences differences. The goal is therefore to better answer the needs of every market. This implies an independency in productivity, meaning that the efficiencies and productivities achieved in each market are unrelated to those taking place in other markets.
Globally integrated**.** Systems of production located in several countries and commonly involving complex products. Logistics activities are highly important as production and distribution capabilities need to be effectively reconciled. This implies an interdependency in productivity, as each component of the supply chain directly impacts the cost and the quality of the final product.
Four major location strategies for Global Production Networks can be identified:

- **Centralized global production**. The entire production occurs within only one nation (or region) and is exported thereafter on the global market. This is particularly the case for activities that are difficult to relocate, such as goods linked to the location of resources, difficult to reproduce (e.g. luxury and craft) or depending on massive economies of scale.
- **Regional production**. Takes place within each region that manufactures a good with the size of the production system related to the size of the regional market. This system depends more on a regional accessibility than on economies of scale. It particularly applies to well known manufacturing technologies and/or to products having high distribution costs (e.g. soft drinks).
- **Regional specialization**. This global production network involves a spatial division ofthe production based on comparative advantages. Each region specializes in the production of a specific good and imports from other regions what it requires.
- **Vertical transnational integration**. This global production network is another variant of specialization. Different stages of the production occur at locations offering the best comparative advantages. Raw materials are extracted from locations where they are the most accessible, while assembly is performed in regions having low labor costs or high skill levels depending on the type of product or the stage in its manufacturing.

Each production sectors has a different production network. The automotive and electronics sectors are good examples of vertical integration. For instance, the manufacture of a television generally implies stages of research and development in the United States and Japan (as well as being important markets). Several nations, such as England, South Korea and Germany provide components. The assembly takes place in low wages countries such as China, Mexico and Thailand. Labor costs are a key element of this system, but also the required level of knows how.

INTERNATIONAL LOCATION DECISIONS:

Major Issues:

The objective of this study is to elicit a consensus of judgments on issues of critical factors in international location decisions and to classify these factors under type of business which firms located, location of manufacturing plant, location of parent company and the nature of business.

The major issues in this study are as follows:

- Identification of motivations of firms that seek to manufacture across the borders.
- Determination of steps in international location decision process.
- Identifying the most difficult problem in making an international location decision

- Identification of factors relating to international location decisions by asking the experts indicates the importance of each of the thirteen major factors using a seven-point scale.
- Explanatory on the importance of sub-factors and the sectors, types of business or countries in which they are most relevant.
- Identifying factors that need to be considered in international location decisions under location of manufacturing plant in different geographical areas i.e. Western Europe, Eastern Europe, Japan,
- United Stated, Middle-East, Far-east, Africa, Latin America from experts' points of view.
- Identifying factors that need to be considered in international location decisions under location of parent company I United States, United Kingdom, Western Europe and Japan from experts'points of view.
- Identifying factors that need to be considered in international location decisions under type of business i.e. Automotive/Motor Vehicles, Electronic Products/IT and Software, Electronic Equipment and Appliances, Textiles/Apparel, Consumer products/ Food and Beverages,Rubber/Plastics, Chemical/Petroleum and Coal and other businesses from experts' points of view.
- Identifying factors that need to be considered in international location decisions under nature of firm i.e. world-class manufacturing, large company and medium-sized company by identifying the top four important factors from experts' points of view.

SCALE OF OPERATIONS:

The cost advantage that arises with increased output of a product.
Economies of scale arise because of the inverse relationship between the quantity produced and per-unit fixed costs; i.e. the greater the quantity of a good produced, the lower the per-unit fixed cost because these costs are shared over a larger number of goods.

Economies of scale may also reduce variable costs per unit because of operational efficiencies and synergies. Economies of scale can be classified into two main types: Internal – arising from within the company; and External – arising from extraneous factors such as industry size.

Economies of Scale and International Trade

One important motivation for international trade is the efficiency improvements that can arise because of the presence of economies of scale in production. Although economists wrote about these effects long ago, models of trade developed after the 1980s introduced economies of scale in creative new ways and became known as the "New Trade Theory."

The WTO can cut the cost of doing business internationally

Many of the benefits of the trading system are more difficult to summarize in numbers, but they are still important.
They are the result of essential principles at the heart of the system, and they make life simpler for the enterprises directly involved in trade and for the producers of goods and services.

Trade allows a division of labor between countries.

It allows resources to be used more efficiently and effectively for production. But the WTO's trading system offers more than that. It helps to increase productivity and to cut costs even more because of important principles enshrined in the system, designed to make life simpler and clearer.
Imagine a situation where each country sets different rules and different customs duty rates for imports coming from different trading partners. Imagine that a company in one country wants to import raw materials or components copper for wiring or touch screens for electronic equipment, for example for its own production.
It would not be enough for this company to look at the prices offered by suppliers around the world. The company would also have to make separate calculations about the different duty

rates it would be charged on the imports (which would depend on where the imports came from), and it would have to study each of the regulations that apply to products from each country.
Buying copper or touch screens would become very complicated. That, in simple terms, is one of the problems of discrimination.
Imagine now that the government announces it will charge the same duty rates on imports from all countries, and will use the same regulations for all products, whether imported or locally produced. Life for the company would be much simpler. Sourcing components would become more efficient and cost less.

Non-discrimination is just one of the key principles of the WTO's trading system. Others include:

- Transparency (clear information about policies, rules and regulations)
- Increased certainty about trading conditions (commitments to lower trade barriers and to increase other countries' access to one's markets are legally binding)
- Simplification and standardization of customs procedure, removal of red tape, centralized databases of information, and other measures to simplify trade, known as "trade facilitation".

Together, they make trading simpler, cutting companies' costs. That, in turn, means more jobs and better goods and services for consumers.

Trade facilitation" has become an important subject in the Doha Round negotiations.
Red tape and other obstacles are like a tax on trade. The saving from streamlining procedures could be 2% –15% of the value of the goods traded, according to estimates by the Organization for Economic Cooperation and Development (OECD). The Peterson Institute for International Economics estimates that it could add $117.8 billion to the world economy (global GDP). The World Bank says that for every dollar of assistance provided to support trade facilitation reform in developing countries, there is a return of up to $70 in economic benefits.

MAKE-OR-BUY DECISION:

Definition:

The act of choosing between manufacturing a product in-house or purchasing it from an external supplier. In a make-or-buy decision, the two most important factors to consider are cost and availability of production capacity.
An enterprise may decide to purchase the product rather than producing it, if is cheaper to buy than make or if it does not have sufficient production capacity to produce it in-house. With
the phenomenal surge in global outsourcing over the past decades, the make-or-buy decision is one that managers have to grapple with very frequently.

Make-or-Buy decision situation:

The make-or-buy decision is the act of making a strategic choice between producing an item internally or buying it externally. The buy side of the decision also is referred to as outsourcing.
Make-or-buy decisions usually arise when a firm that has developed a product or part or significantly modified a product or part is having trouble with current suppliers, or has diminishing capacity or changing demand.
Make-or-buy analysis is conducted at the strategic and operational level. Obviously, the strategic level is the more long-range of the two. Variables considered at the strategic level include analysis of the future, as well as the current environment. Issues like government regulation, competing firms, and market trends all have a strategic impact on the make-or-buy decision. Of course, firms should make items that reinforce or are in-line with their core competencies. These are areas in which the firm is strongest and which give fireir 2003 book World Class Supply

Management, David Burt, Donald Dobler, andStephen Starling present a rule of thumb for out-sourcing.
It prescribes that a firm outsource all items that do not fit one of the following three categories:
(1) The item is critical to the success of the product, including customer perception of important product attributes
(2) The item requires specialized design and manufacturing skills or equipment, and the number of capable and reliable suppliers is extremely limited
(3) The item fits well within the firm's core competencies, or within those the firm must develop to fulfill future plans. Items that fit less than one of these three categories are considered strategic in nature and should be produced internally if at all possible.

Make-or-buy decisions also occur at the operational level.

- Desire to integrate plant operations
- Productive use of excess plant capacity to help absorb fixed overhead
- Need to exert direct control over production and/or quality
- Better quality control
- Design secrecy is required to protect proprietary technology
- Unreliable suppliers
- No competent suppliers
- Desire to maintain a stable workforce (in periods of declining sales)
- Quantity too small to interest a supplier
- Control of lead time, transportation, and warehousing costs
- Greater assurance of continual supply
- Provision of a second source Political, social or environmental reasons (union pressure)
- Emotion (e.g., pride)

Factors that may influence firms to buy a part externally include:

- Lack of expertise
- Suppliers' research and specialized know-how exceeds that of the buyer
- cost considerations (less expensive to buy the item)
- Small-volume requirements
- Limited production facilities or insufficient capacity
- Desire to maintain a multiple-source policy
- Indirect managerial control considerations
- Procurement and inventory considerations
- Brand preference
- Item not essential to the firm's strategy

The two most important factors to consider in a make-or-buy decision are cost and the availability of production capacity. Burt, Dobler, and Starling warn that "no other factor is subject to more varied interpretation and to greater misunderstanding" Cost considerations should include all relevant costs and be long-term in nature. Obviously, the buying firm will compare production and purchase costs. Burt, Dobler, and Starling provide the major elements included in this comparison. Elements of the "make" analysis include:

- Incremental inventory-carrying costs
- Direct labor costs
- Incremental factory overhead costs
- Delivered purchased material costs
- Incremental managerial costs
- Any follow-on costs stemming from quality and related problems
- Incremental purchasing costs
- Incremental capital costs

Cost considerations for the "buy" analysis include:

- Purchase price of the part
- Transportation costs
- Receiving and inspection costs
- Incremental purchasing costs
- Any follow-on costs related to quality or service

One will note that six of the costs to consider are incremental. By definition, incremental costs would not be incurred if the part were purchased from an outside source. If a firm does not currently have the capacity to make the part, incremental costs will include variable costs plus
the full portion of fixed overhead allocable to the part's manufacture.
If the firm has excess capacity that can be used to produce the part in question, only the variable overhead caused by production of the parts are considered incremental. That is, fixed costs, under conditions of sufficient idle capacity, are not incremental and should not be considered as part of the cost to make the part. While cost is seldom the only criterion used in a make-or-buy decision, simple break-even analysis can be an effective way to quickly surmise the cost implications within a decision.

Situation of Make-or-Buy Decisions:

International businesses frequently face sourcing decisions, decisions about whether they should make or buy the component parts that go into their final product. Should the firm vertically integrate to manufacture its own component parts or should it outsource them, or buy them from independent suppliers? Make-or-buy decisions are important factors of many firms' manufacturing strategies. In the automobile industry, for example, the typical car contains more than 10,000 components, so automobile firms constantly face make-or-buy decisions. Ford of Europe, for example, produces only about 45 percent of the value of the Fiesta in its own plants. The remaining 55 percent, mainly accounted for by component parts, come from independent suppliers. In the athletic shoe industry, the make-or-buy issue has been taken to an extreme with companies such as Nike and Reebok having no involvement in manufacturing; all production has been outsourced, primarily to manufacturers based in low-wage countries. Make-or-buy decisions pose plenty of problems for purely domestic businesses but even more problems for international businesses. These decisions in the international arena are complicated by the volatility of countries' political economies, exchange rate movements, changes in relative factor costs, and the like.

THE ADVANTAGES OF MAKE:

The arguments that support making component parts in-house--vertical integration--are fourfold. Vertical integration may be associated with lower costs, facilitate investments in highly specialized assets, protect proprietary product technology, and facilitate the scheduling of adjacent processes.

- **Lower Costs**

It may pay a firm to continue manufacturing a product or component part in-house if the firm is more efficient at that production activity than any other enterprise. Boeing, for example, recently undertook a very detailed review of its make-or-buy decisions with regard to commercial jet aircraft (for details see the accompanying Management Focus). It decided that although it would outsource the production of some component parts, it would keep the production of aircraft wings in-house.
Its rationale was that Boeing has a core competence in the production of wings, and it is more efficient at this activity than any other comparable enterprise in the world. Therefore, it makes little sense for Boeing to out-source this particular activity.

➢ **Facilitating Specialized Investments**

We first encountered the concept of specialized assets in Chapter 6 when we looked at the economic theory of vertical foreign direct investment. A variation of that concept explains why firms might want to make their own components rather than buy them. The argument is that when one firm must invest in specialized assets to supply another, mutual dependency is created. In such circumstances, each party fears the other will abuse the relationship by seeking more favorable terms.

➢ **Proprietary Product Technology Protection**

Proprietary product technology is technology unique to a firm. If it enables the firm to produce a product containing superior features, proprietary technology can give the firm a competitive advantage. The firm would not want this technology to fall into the hands of competitors. If the firm contracts out the manufacture of components containing proprietary technology, it runs the risk that those suppliers will expropriate the technology for their own use or that they will sell it to the firm's competitors. Thus, to maintain control over its technology, the firm might prefer to make such component parts in-house.

An example of a firm that has made such decisions is given in the accompanying Management Focus, which looks at make-or-buy decisions at Boeing. While Boeing has decided to outsource a number of important components that go toward the production of an aircraft, it has explicitly decided not to outsource the manufacture of wings and cockpits because it believes that doing so would give away key technology to potential competitors.

➢ **Improved Scheduling**

The weakest argument for vertical integration is that production cost savings result from it because it makes planning, coordination, and scheduling of adjacent processes easier. This is particularly important in firms with just-in-time inventory systems. In the 1920s, for example, Ford profited from tight coordination and scheduling made possible by backward vertical integration into steel foundries, iron ore shipping, and mining. Deliveries at Ford's foundries on the Great Lakes were coordinated so well that ore was turned into engine blocks within 24 hours. This substantially reduced Ford's production costs by eliminating the need to hold excessive ore inventories.

ADVANTAGES OF BUY:

The advantages of buying component parts from independent suppliers are that it gives the firm greater flexibility, it can help drive down the firm's cost structure, and it may help the firm to capture orders from international customers.

➢ **Strategic Flexibility**

The great advantage of buying component parts from independent suppliers is that the firm can maintain its flexibility, switching orders between suppliers as circumstances dictate. This is particularly important internationally, where changes in exchange rates and trade barriers can alter the attractiveness of supply sources. One year Hong Kong might be the lowest-cost source for a particular component, and the next year, Mexico may be.

Sourcing component parts from independent suppliers can also be advantageous when the optimal location for manufacturing a product is beset by political risks. Under such circumstances, foreign direct investment to establish a component manufacturing operation in that country would expose the firm to political risks. The firm can avoid many of these risks by buying from an independent supplier in that country, thereby maintaining the flexibility to switch sourcing to another country if a war, revolution, or other political change alters that country's attractiveness as a supply source.

However, maintaining strategic flexibility has its downside. If a supplier perceives the firm will change suppliers in response to changes in exchange rates, trade barriers, or general specialized investments in plant and equipment that would ultimately benefit the firm.

- **Lower Costs**

Although vertical integration is often undertaken to lower costs, it may have the opposite effect. When this is the case, outsourcing may lower the firm's cost structure. Vertical integration into the manufacture of component parts increases an organization's scope, and the resulting increase in organizational complexity can raise a firm's cost structure. There are three reasons for this. First, the greater the number of subunits in an organization, the greater is the problems of coordinating and controlling those units. Coordinating and controlling subunits requires top management to process large amounts of information about subunit activities. The greater the number of subunits, the more information top management must process and the harder it is to do well.

- **Offsets**

Another reason for outsourcing some manufacturing to independent suppliers based in other countries is that it may help the firm capture more orders from that country. As noted in the Management Focus on Boeing, the practice of offsets is common in the commercial aerospace industry. For example, before Air India places a large order with Boeing, the Indian government might ask Boeing to push some subcontracting work toward Indian manufacturers. This kind of quid pro quo is not unusual in international business, and it affects far more than just the aerospace industry. Representatives of the US government have repeatedly urged Japanese automobile companies to purchase more component parts from US suppliers in order to partially offset the large volume of automobile exports from Japan to the United States.

- **Trade-offs**

Trade-offs is involved in make-or-buy decisions. The benefits of manufacturing components in-house seem to be greatest when highly specialized assets are involved, when vertical integration is necessary for protecting proprietary technology, or when the firm is simply more efficient than external suppliers at performing a particular activity. When these conditions are not present, the risk of strategic inflexibility and organizational problems suggest that it may be better to contract out component part manufacturing to independent suppliers. Since issues of strategic flexibility and organizational control loom even larger for international businesses than purely domestic ones, an international business should be particularly wary of vertical integration into component part manufacture. In addition, some outsourcing in the form of offsets may help firm gain larger orders in the future.

- **Strategic Alliances with Suppliers**

Several international businesses have tried to reap some of the benefits of vertical integration without the associated organizational problems by entering strategic alliances with essential suppliers. For example, in recent years we have seen an alliance between Kodak and Canon, under which Canon builds photocopiers for sale by Kodak, and an alliance between Apple and Sony, under which Sony builds laptop computers for Apple. By these alliances, Kodak and Apple have committed themselves to long-term relationships with these suppliers, which have encouraged the suppliers to undertake specialized investments. Recall from our earlier discussion that a lack of trust inhibits suppliers from making specialized investments to supply a firm with inputs. Strategic alliances build trust between the firm and its suppliers. Trust is built when a firm makes a credible commitment to continue purchasing from a supplier on reasonable terms. For example, the firm may invest money in a supplier--perhaps by taking a minority shareholding--to signal its intention to build a productive,mutually beneficial long-term relationship.

This kind of arrangement between the firm and its parts suppliers was pioneered in Japan by large auto companies such as Toyota. Many Japanese automakers have cooperative relationships with their suppliers that go back for decades. In these relationships, the auto companies and their suppliers collaborate on ways to increase value - added by, for example, implementing just-in-time inventory systems or cooperating in the design of component parts to improve quality and reduce assembly costs. These relationships have been formalized when the auto firms acquired minority shareholdings in many of their essential suppliers to symbolize their desire for long-term cooperative relationships with them.

At the same time, the relationship between the firm and each essential supplier remains market mediated and terminable if the supplier fails to perform up to standard. By pursuing such a strategy, the Japanese automakers capture many of the benefits of vertical integration, particularly those arising from investments in specialized assets, without suffering the organizational problems that come with formal vertical integration. The parts suppliers also benefit from these relationships because since they grow with the firm they supply and they share in its success.

Because of these strategies, Toyota manufactures only 27 percent of its component parts in-house, compared to 48 percent at Ford and 67 percent at GM. Of these three firms, Toyota appears to spend the least on component parts, suggesting it has captured many of the benefits that induced Ford and GM to vertically integrate. In general, the trends toward just-in-time systems (JIT), computer-aided design (CAD),and computer-aided manufacturing (CAM) seem to have increased pressures for firms to establish long-term relationships with their suppliers. JIT, CAD,
and CAM systems all rely on close links between firms and their suppliers supported by substantial specialized investment in equipment and information systems hardware. To get a supplier to agree to adopt such systems, a firm must make a credible commitment to an enduring relationship with the supplier--it must build trust with the supplier. It can do this within the framework of a strategic alliance.

GLOBAL SUPPLY CHAIN ISSUES:

Supply chain management (SCM) is "the systemic, strategic coordination of the traditional business functions and the tactics across these business functions within a particular company and across businesses within the supply chain, for the purposes of improving the long term performance of the individual companies and the supply chain as a whole." It has also been defined as the "design, planning, execution, control, and monitoring of supply chain activities with the objective of creating net value, building a competitive infrastructure, leveraging worldwide logistics, synchronizing supply with demand and measuring performance
globally."

Main functions of Supply Chain Management are as follows:

- Inventory Management
- Distribution Management
- Channel Management
- Payment Management
- Financial Management
- Supplier Management
- Transportation Management
- Customer Service Management

GLOBAL SUPPLY CHAIN MANAGEMENT:

- Through every phase of a product's lifestyle, global supply chain management professionals ensure that customers get the products and services they need and want faster, better and more cost-effectively from across town or around the world. They play a critical role to the successful functioning of businesses, healthcare, nonprofit agencies and governments.
- A "supply chain" refers to the collection of steps that a company takes to transform raw material components into a final product that is delivered to customers. Typically, supply chain management has five stages: plan, make, source, deliver and return.
- Every stage of that process involves professional skills that are critical to success, from marketing and logistics to data management and warehousing.
- Our GSCM graduates find a wealth of different career tracks that offer both financial rewards and personal satisfaction.

Every successful organization owes some of its success to effective supply chain management and logistics.
These processes focus on the flow of goods and information from the source of raw materials through the distribution channels to the final consumer, and beyond, to recycling and disposal.

In today's competitive environment, managing transportation, inventory, product plans and schedules, and information flows are critical to satisfying customers and creating competitive advantages.
Organizations compete globally by working with international suppliers, outsourcing, and marketing to consumers worldwide. This global reality places even more importance on successful supply chain management.
The global supply chain management major focuses on global business and prepares students for success. And with the flexibility of multiple campuses and online courses, you can personally tailor your educational experience.
Courses provide insight into many subjects, including:

- Managing raw materials and finished products
- Developing transportation and logistics strategies
- Merging transportation policies with production and marketing plans
- Global supply chain analysis and planning

MANAGING GLOBAL SUPPLY CHAIN:

Globalization is one of those politically charged words that often imply more than it actually means. From the relatively benign “the world is flat” philosophy that suggests offshore factories help stimulate U.S. imports, to the “off shoring costs American jobs” idea that everything can and should be made in the United States, everybody in manufacturing has an opinion on whether globalization is good or bad for their companies and/or their fellow citizens.

Some might suggest, in fact, that globalization is a fait accompli. As Daniel Ackerson, chairman and CEO of General Motors Co. (IW 500/4) pointed out at a news conference in 2011, seven out of 10 of all GM vehicles are made outside the United States, and the trend shows no signs of stopping.

There’s nothing very new about globalization, though, a concept that basically refers to the practice of sourcing, manufacturing, transporting and distributing products outside of your native country. Its modern application predates the rise of the Internet by a good 40 years, beginning in the early 1950s when container shipping was introduced, making it possible to quickly, efficiently and economically move entire container loads onto ocean vessels at ports of call throughout the world.

As the world has gotten flatter and supply chains have gotten longer, the need for companies to follow best practices in global supply chain management has intensified. Gary Miller has a deep familiarity with such a role, having spent 40 years as vice president, global supply chain and chief procurement officer with $23 billion tire manufacturer Goodyear Tire and Rubber Co. (IW 500/54) before taking on the same role in 2008 at A. Schulman Inc. a $2.5 billion plastics manufacturer. As Miller explains it, he’s responsible for Schulman’s supply chain and procurement activities to better leverage its worldwide purchasing power, reduce materials inventories, eliminate waste and improve efficiency. The company has 35 facilities globally, with nearly 70% of its revenues derived out of the European market. “We have global customers that we service around the world,” he says. “Europe is a very large region for us, so we have deep relationships with our customers there. As those customers expand around the world, they’re also looking for us to come with them.”

QUALITY CONSIDERATIONS IN INTERNATIONAL BUSINESS:

Outsourcing is a strategic management option rather than just another way to cut costs. The decision to outsource is often made in the interests of lowering costs, redirecting or conserving energy directed at the competencies of a particular business, or to make more efficient use of labor, capital, technology and resources. Its aim is to help companies achieve their business objectives through operational excellence.

One aspect of this is QA and testing. This can provide many benefits to companies, who are seeking to improve the quality of their production applications, reduce business risk through rigorous testing and augment and improve upon the incumbent testing teams and processes. Given the increase in global IT outsourcing agreements, many companies will be looking at outsourcing QA and testing as an independent validation and acceptance phase in order to ensure high quality deliverables and gain competitive advantages.

To achieve these benefits, organizations select an outsourcing partner who will typically have local and offshore test centers and capabilities as well as a strong onsite consultancy presence.

Some of the critical success factors for outsourcing QA and testing engagements include:

- Ensuring that the business objectives agreed at the outset of the contract or business caseare managed through to successful completion
- Ensuring that transition from the "testing today" to "tomorrow’s testing" is seamless in terms of business impact and employee satisfaction
- Noticeable and continuous improvements in the approach and methods used within your IT organization (not just testing)

Challenge of outsourcing

- **Incremental Outsourcing**

Organizations can mitigate their risks of outsourcing by dividing the work into small, more manageable projects that they outsource to service providers. Managers at the client
organization therefore have well defined deliverables, programs that work under an umbrella contract with associated schedules. The location of the work is determined on a project by project basis.

- **Total Outsourcing - Onsite/Offshore**

In this model, multiple projects and programs at the client organizations are outsourced to a service provider, which also takes on the end-to-end program management and delivery on behalf of the client. The service provider takes on the project, module or program from a client organization, deploys a small team onsite that works with the client managers and teams and coordinates work with the offshore team that does the bulk of the work. Typical models range from 20-30% onsite to 70-80% offsite.

1. Engagement Models

Selecting an engagement model is a crucial aspect of developing the outsourcing plan. The process involves several factors, including aspects of international business strategy, selecting the geographical location, understanding the landscape and deciding on the outsourcing strategy. Some of the engagement models are:

2. Service Level Agreements (SLAs)

The SLAs should detail the minimum level of service to be provided by the outsourcing vendor. They should be objective and measurable and have no ambiguity. This helps both parties in the long term. Some good examples of the type of SLAs that should be considered are:

- **On time delivery** - dates must be agreed from the outset on all major deliverables with all efforts to ensure they are met. Use change control processes if these dates need to be moved.
- **Client Satisfaction** - periodic surveys should be conducted to make sure that the service provided by the outsourcing company is satisfactory to customers.
- **Effectiveness** - effectiveness metrics focus on lowering costs, improving profit, and adjusting business transactions
- **Volume of Work** - the volume of work sometimes is difficult to define. For example, projects that are billed on a time-and-material basis may discuss volume in terms of number of resources, while a fixed-price project usually specifies number of deliverables. This metric is an important part of the SLA.
- **Sensitivity** - sensitivity metrics measure the amount of time required for an outsource company to handle a request.
- **System Downtime and Availability** - in outsourcing, guaranteeing 100% availability of services costs significantly more than guaranteeing 99% or 98%, and not every company or every application needs 100% reliability. The SLA should request service availability to meet specific business needs.

It is also good to ensure that SLAs are tied into the contract, sometimes on a risk/reward basis to ensure that there is mutual interest in meeting them.

3. Mobilization

Once the contract is signed there will be a period of mobilization for both parties. This phase generally includes setting up communication protocol with the client, defining work breakdown structure, sharing standard templates (used for authoring test cases, reporting project status, presenting the key metrics etc.) with the client, building test strategy etc. Some of the key elements of this can be seen below:

The outsourcing providers maintain a pool of highly qualified and dedicated professionals including QA engineers, QA leads, project managers and technical specialists. Many outsourcing providers have unique centers of excellence to train their interns and employees on various testing methodologies and tools that are required for seamless execution of the engagement. Ensuring the most appropriate resources for your requirements are in place is critical for the success of the engagement.

Knowledge Acquisition

Outsourcing providers follow various approaches to obtain adequate knowledge for the test engineers to understand the core business requirements and also the critical functionality to be tested. Test leads or managers will be sent onsite long/short term to meet various stakeholders in the client organization to understand the product/system and its features. They will assume the responsibility of training the offshore team on the product/system to be tested and all the features of it that the client and the outsourcing vendor have agreed to be tested.

Infrastructure

Some applications require extensive compatibility testing in different environments and back-end database systems. Other applications need to be tested in production-sized environments that closely resemble the final production environment. Outsourcing providers, with their extensive test labs, should stimulate the production environment for performing such complex levels of testing. The cost for setting up this environment offshore would be negotiated with customers with a cost effective solution being drawn in favor of both parties.

Processes

Outsourcing providers in this competitive industry are continuously working on raising their standards with respect to adhering to CMMi Level 5 and other standard ISO processes to ensure tangible benefits for their customers. These include low project risk, on time/on budget deliveries, minimal error rate, high process visibility and enhanced customer satisfaction. Process implementation not only suggests complying to standard guidelines and procedures but also gives greater visibility to customers by delivering metrics (such as schedule/effort variance, productivity etc.) that measure the quality of the product/system which is the ultimate aim for any outsourcing provider.

4. Integration with other third party service providers

Independent QA and testing is becoming more and more common. One of the reasons for this is that it provides objective rigor and thoroughness that might not be provided by a single vendor. However, in this scenario, it is important that all the parties (client, testing vendor and development vendor) work harmoniously to achieve the right result.

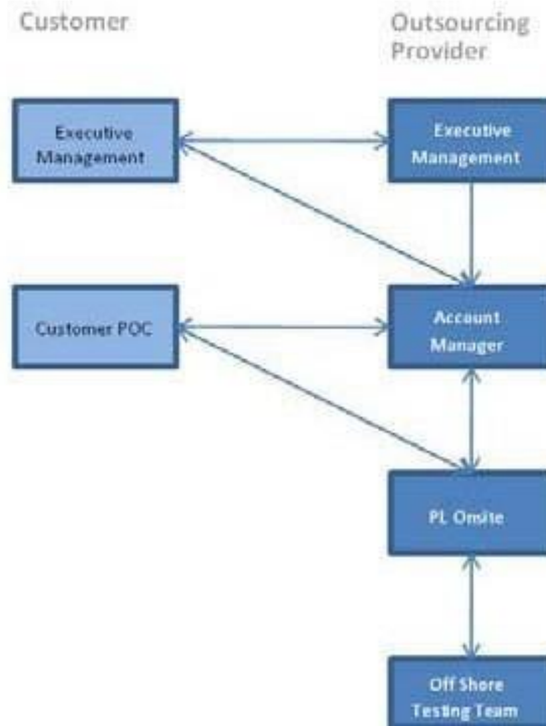
The testing provider should have a good understanding of the challenges involved in working with multiple vendors spread across geographies and develop appropriate interfaces and best practices in communication to ensure successful completion of engagements. Understanding other SDLC methods is also imperative.

A clearly defined defect management and resolution process should be established as a high priority and ensuring consistent reporting styles on progress will make it easier on all parties to assess the readiness of any application throughout its lifecycle.

5. Communication:

Outsourcing providers facilitate seamless communication between the client and their stakeholders. As communication is considered a key obstacle in outsourcing, providers maintain effective channels and points of contact (POC) open to clients.

An effective model and plan (including methods) should be tailored to the needs of the client and would help both parties in identifying and resolving issues promptly. A typical communication flow model is shown below:



Escalation and Issue Resolution

There needs to be a clear and objective escalation and issue resolution process agreed from the outset. Early identification should be built into the standard project risks and issues logs as well as action plans for mitigation. Successful processes work best when there is a trusting relationship between the vendor and the client.

Reporting

It is important that formal reporting is put in place and communicated by a regular set of reports and deliverables updating the client on the engagement (at project/IT organization level). These reports will be sent to the client on a daily, weekly, bi-weekly or on a monthly basis based on the nature of the reports and the agreed plan. This should be in addition to the less formal reporting that will become apparent through the personal relationships formed.

6. Flexibility and Scalability

QA and testing outsourcing agreements demand a degree of flexibility and scalability to help ensure fluctuations in scope and timescales can be met. Some of the scenarios where flexibility is required are:

- New or enhanced systems require revised testing commitments
- More releases require more testing phases
- Increased levels of system or data integration require wider scope and coverage in testing
- Regression test demands will grow as systems are developed

Performance and load test and other special tests may place demands on the service

The outsourcing provider must have an organization with infrastructure and resources sufficiently sized so that the client demands are met. The correct scope and planning helps prevent this but some eventualities are unavoidable. It is therefore important that clients have an expectation that should the nature of the requirements change, there will be provision made within the contract or through good change management processes.

7. Quality Improvement

The key objective of the client is often to gain a significant improvement in quality and this can be achieved through outsourcing. In order to do this, there are some fundamental steps that need to be taken. The outsourcing provider needs to assess and map the client.s testing capability to understand how the engagement is going to work. Identifying the "major gaps" in test processes from the outset and implementing positive changes to address these will result in quality

improvements. As the relationship matures between the two parties, there should be a willingness to continually improve process and working methods etc. This should not necessarily be restricted to just testing, but the whole lifecycle if it improves the end product.

8. Configuration and Change Management

Many businesses have frequently changing requirements which if handled badly can have a significant impact on time, quality and cost. To help clients overcome this, QA and testing outsourcing organizations maintain a comprehensive change and configuration management system. A typical scenario would be that a Change Request is raised by a client and sent to the
vendor. The team then consolidates all Change Requests and performs an impact analysis on the Project Schedule, resources, costs and assesses the technical feasibility of the changes. These are all taken into account before the assessment is discussed with the client. Upon approval, an updated Project Schedule will be laid out to execute that change request.

9. Intellectual Property Protection

Intellectual Property (IP) protection is one of the important considerations for customers when outsourcing services. QA and testing outsourcing providers have to protect all Personally Identifiable Information (PII) given by clients or otherwise obtained in the course of outsourcing engagements and treat it as proprietary and/or trade secrets. Unauthorized use or disclosure by the QA and testing services provider of any PII will be detrimental to the client.s competitive position and on-going business operations. The QA and outsourcing provider.s staff should not duplicate, distribute, disclose, convey or in any other manner make available to third parties any PII. Most of the outsourcing providers have well established security standards and measures in place to prevent unauthorized access to and misuse of PII. The IP protection policies of most of the outsourcing service providers have the following:

- Non-disclosure agreements signed with the client
- Project related IP protection
- Employee Confidentiality contract

10. Security

All the major outsourcing providers have Information Security Policies, Information Security Standards and Business Continuity Management policies in place, primarily to protect data. The facilities of the outsourcing providers will have the controls and capability to prevent loss or accidental release of data or proprietary functionality. In the event of a disaster they should have the capacity to subsequently restore a service relevant to this. The testing facilities of most of the outsourcing providers are assessed for BS7799 security management standards. Security measures are implemented at various levels at the facilities of the outsourcing provider that include physical security, infrastructure, network security and other ad hoc security measures based on specific case/project. Some of the physical security measures provided by outsourcing vendors include measures to restrict the entry and exit of personnel, equipment and media from a designated area. These controls address not only the area containing system hardware but also the locations of wiring, supporting services, backup media and other elements required for the system’s operation.

Seven Considerations for International Licensing

Apparel companies are now, more than ever before, recognizing the great potential in having a global presence. Licensing is a cost-effective way for small to medium-size companies to "plant their flag" overseas, without launching speculative joint ventures or wholly-owned subsidiaries. As a licensor, a company can springboard off a local licensee that has the expertise and presence in a particular brand category, with the critical knowledge of local markets and tastes.
Licensing represents a way to move a brand into new businesses, new geographical markets and new distribution channels that otherwise would be unavailable without making a major investment in new manufacturing processes, machinery, or facilities, while maintaining

control over the brand image. Licensing in global markets offers important advantages, but apparel companies should keep a number of other factors in mind, such as the many cultural, linguistic, political, legal and financial differences that exist in different countries.

1. Brand identity. First and foremost, an apparel firm seeking to become a licensor must evaluate whether an international licensing arrangement will enhance and improve the company's brand. Putting the brand into the hands of an overseas licensee requires proper due diligence, as there is potential for brand damage. The company needs to be sure the licensee can create and
deliver products that are of the agreed upon quality, whose goals for the brand coincide with those of the licensor, and who will be a true partner in furthering the licensor's brand identity. Also, apparel enterprises run the risk of creating or strengthening a potential competitor should they decide to enter that market on their own in the future.

It is also important to understand and limit the time commitments that will be involved from a creative and management point of view, and that the proper person in the company is in charge of the international licensing program.

2. Selecting a licensee:

After thoroughly assessing the new market's potential, compile a list of promising licensee candidates. International trade show organizers and trade associations can be helpful in identifying and assisting with due diligence. If possible, try to speak with the licensee's past customers. Search for feedback on the licensee, for example, through the internet or in trade publications.

After meeting a prospective licensee, preferably in person, try to work with the prospective licensee on a trial basis if possible, and trust your intuition. The company also needs to evaluate whether the licensee has the financial strength to perform its obligations to promote the identity of the brand in a manner that will satisfy the stated objectives.

Contract terms

Key issues to address include: which products and trademarks are covered, the royalty arrangements and design fees, whether the arrangement is exclusive or nonexclusive, and the definition of the design and approval relationships relating to the products and product promotions. If any training is involved, any extra fees or charges need to be identified. Advertising and other financial obligations need to be clearly defined.

3. License grant

The initial step is to define the products and trademarks to be covered and the rights to be granted in the license agreement. A licensor can control the scope of the license by including and excluding certain products and trademarks, incorporating exclusivity and territorial restrictions, and limiting assignment and sublicensing arrangements.

4. Territory

A strong licensee in one country is not necessarily a strong licensee in another. Care should be taken in defining the territory and determining if the territory is exclusive or nonexclusive. Provisions prohibiting licensees from sublicensing or selling into other territories should be included as well. Since the brand is the most important product, in addition to making sure translated materials are accurate and properly credited, a licensor should always take the time to register its trademarks and copyrights in the countries in which it plans to license its products.

Although it is expensive, it is cheaper than buying those rights back from squatters.

5. Royalties and other payments

Most licensing arrangements include initial up-front payments that are generally nonrefundable license fees, used to compensate the licensor for the costs of investigating the

or varied based on a percentage of sales or other factors. Royalties are typically structured with minimum payments to ensure that the licensor will have a reliable royalty stream.

6. Approvals and other controls

The licensor will want to include provisions in the agreement allowing the licensor (or a designated representative or agent) to have periodic inspection rights of the manufacturing facilities to ensure the quality of the goods produced, and also to monitor whether the licensee is counterfeiting or otherwise engaging in illegal or unapproved labor or business practices. Even if a licensor is not likely to conduct such inspections, including these provisions is prudent.

7. Term and termination

The duration of the agreement is negotiable. If the licensee is planning to make a substantial investment in launching the brand overseas, it is not uncommon to have a 3-, 5-, or even 10-year agreement, with options to renew. This is often balanced by the licensor with a minimum sales requirement to ensure that the licensee will be actively marketing the licensed products. The duration of the license, and any renewal provisions need to be clearly set forth in the agreement.

GLOBALIZATION IN MARKETS:

Globalization refers to the changes in the world where we are moving away from selfcontained countries and toward a more integrated world. Globalization of business is the change in a business from a company associated with a single country to one that operates in multiple countries.

Impact of Globalization

Imagine for a moment that you run a business that produces digital cameras. How would globalization impact your company?

Market Globalization & Production Globalization.

Market globalization is the decline in barriers to selling in countries other than the home country. This change will make it easier for your company to begin selling products internationally, since lower tariffs keep consumer prices lower and fewer restrictions when crossing borders makes it easier for a company to enter a foreign market. It also means that companies must consider other cultures when developing their business strategies and potentially adjust the product and marketing messages if they aren't appropriate in the target country. This may not be an issue in the camera industry, but a hamburger company entering India would definitely need to revisit their product and strategies to be successful!
Production globalization is the sourcing of materials and services from other countries to gain advantage from price differences in different nations. For example, you might purchase materials and components for your cameras from multiple countries and then assemble the product in yet another international location to reduce your costs of production. This change should lead to lower prices for consumers, since products cost less to produce. It also impacts jobs, since production may shift from one country to another, usually from more developed countries to less developed countries with lower average wage rates.

INTERNATIONAL MARKETING STRATEGY:

Usually, selling focuses on the needs of the seller, marketing on the needs of the buyer (customer). The purpose of business is to get and keep a customer. Or, to use Peter Drucker`s more refined construction to create and keep a customer. (Through product Differentiation and price competition)

International marketing involves the marketing of goods and services outside the organization`s home country. Multinational marketing is a complex form of international marketing that engages an organization in marketing operations in many countries. Global marketing refers to marketing activities coordinated and integrated across multiple Markets.

A firm`s overseas involvement may fall into one of several categories:

1. Domestic: Operate exclusively within a single country.
2. Regional exporter: Operate within a geographically defined region that crosses national boundaries. Markets served are economically and culturally homogenous. If activity occurs outside the home region, it is opportunistic.
3. Exporter: Run operations from a central office in the home region, exporting finished goods to a variety of countries; some marketing, sales and distribution outside the home region.
4. International: Regional operations are somewhat autonomous, but key decisions are made and coordinated from the central office in the home region. Manufacturing and assembly, marketing and sales are decentralized beyond the home region. Both finished goods and intermediate products are exported outside the home region
5. International to global: Run independent and mainly self-sufficient subsidiaries in a range of countries. While some key functions (R&D, sourcing, financing) are decentralized, the home region is still the primary base for many functions. 6- Global: Highly decentralized organization operating across a broad range of countries. No geographic area (including the home region) is assumed a priori to be the primary base for any functional area. Each function including R&D, sourcing, manufacturing, marketing and sales is performed in the locations around the world most suitable for that function.

Global Marketing Strategies:

Although some would stem the foreign invasion through protective legislation, protectionism in the long run only raises living costs and protects inefficient domestic firms (national controls). The right answer is that companies must learn how to enter foreign markets and increase their global competitiveness. Firms that do venture abroad find the international marketplace far different from the domestic one. Market sizes, buyer behavior and marketing practices all vary, meaning that international marketers must carefully evaluate all market segments in which they expect to compete. Whether to compete globally is a strategic decision (strategic intent) that will fundamentally affect the firm, including its operations and its management. For many companies, the decision to globalize remains an important and difficult one (global strategy and action).

Typically, there are many issues behind a company`s decision to begin to compete in foreign markets. For some firms, going abroad is the result of a deliberate policy decision (exploiting market potential and growth); for others, it is a reaction to a specific business

opportunity (global financial turmoil, etc.) or a competitive challenge (pressuring competitors). But, a decision of this magnitude is always a strategic proactive decision rather than simply a reaction (learning how to business abroad). Reasons for

Global expansion is mentioned below:

a) Opportunistic global market development (diversifying markets)
b) Following customers abroad (customer satisfaction)
c) Pursuing geographic diversification (climate, topography, space, etc.)
d) Exploiting different economic growth rates (gaining scale and scope)
e) Exploiting product life cycle differences (technology)
f) Pursuing potential abroad
g) Globalizing for defensive reasons
h) Pursuing a global logic or imperative (new markets and profits)

CHALLENGES IN PRODUCT DEVELOPMENT:

- **The cost of manufacturing**, distributing and marketing the product.
- **The actual physical location** of production plants.
- **Currency Exchange Rates -** US export companies are benefiting from a relatively low US Dollar price during the 2010s. Most hearing aid companies, however, these are based in Europe and therefore the high value of the Swiss Franc and the Euro relative to other currencies must be considered. This make imports into the United States from these countries expensive, but exports from the US relatively cheap to other nations. This has to do not just with demand for a particular product, but also with macroeconomic demand for national currencies, which affects inflation and, by extension, pricing. Currency fluctuations also make it very difficult for companies to make long- term decisions – such as building large factories in global markets. For example, the costs of production may be cheap today, but they could be expensive in the future, impacting upon the price that a manufacturer is forced to charge.
- The price that the international consumer is willing to pay for the product. The manufacturer's business objectives. For example, large international companies such as Starbucks may be willing to operate at a loss in some locations because they need a local presence to maintain their economies of scale, as well as their reputation as a global player. Some hearing aid manufacturers act similarly in order to become "world players."
- **The price that competitors** in international markets are already charging.
- **Business environment** factors such as government policy and taxation.
- **National Market Size** – A company will often attempt to use the potential volume of sales to estimate the price at which it will need to market a product to break even. For larger countries with the potential for more sales, this price may be set lower; for smaller countries, the price maybe higher.
- **Cultural Differences** – One of the more complicated factors in international pricing is cultural variation among companies. Cultural variations that affect pricing can take many forms, most of which have to do with how members of certain cultures perceive the value of certain products, which in turn affects how much they are willing to pay for them. Some cultures do not value amplification products and they are seen with significant stigma. Thus, hearing aid prices can be greatly affected depending upon whether a manufacturer's device is large and obvious or invisible.
- **Regulations** – When setting prices in other countries, companies must research all national regulations relevant to their product, as many countries set price ceilings as well as price floors on certain products. Others require Value Added Tax (VAT) and other taxes that must be considered during the pricing decisions.

NINE STEPS TO AN INTERNATIONAL MARKETING STRATEGY:

As technology breaks down geographic and cultural communication barriers, even small businesses can often tap into the global marketplace. If you think your business is too small to pursue international business opportunities, think again. Get a jump on those opportunities by following the 9 steps outlined below.

Research

Unless you spend excessive amounts of time in foreign countries or soak up knowledge like a Jeopardy Champion, you're probably not able to make an informed decision about a global strategy without doing your homework first. Start with the low-hanging fruit: talk to your coworkers, peers, family and friends. Find out what you can about countries and markets with
the greatest potential. Read relevant print and Web publications voraciously (I prefer e-marketer, Economist, Wall Street Journal and Yahoo! for general business and market research). Compile information about various opportunities and determine which markets have the greatest overall potential (in case you've been hiding in a cave, here's an emerging and growth market cheat sheet for you: China, India, South America, Russia and The Middle East).

Most small to medium-sized businesses do not have the resources on staff to undertake a global market strategy. Assuming there are sufficient opportunities abroad, it's time to determine how to develop appropriate resources (i.e. in-country sales and support, logistics and fulfillment). In the build vs. buy decision, many companies prefer to minimize financial risk by partnering with companies that have extensive experience within the target market to provide those resources. While partnering minimizes risk, there are drawbacks, such as lack of direct management oversight. Those negatives can be alleviated by hiring employees who have the education, experience and native language skills relevant to your target market. International students are excellent resources: they are educated, affordable, multi-lingual and usually have some relevant work experience. The potential downside is that you'll probably have to navigate through a bushel of red tape in order to secure work visas.

Partner:

While your core business and marketing team may already be in place, there are a variety of reasons to explore additional partnerships. Companies specializing in marketing, logistics and customer service are excellent additions to the growing team. Partners within the target market may have relationships with your potential customers that can be leveraged for business development. For instance, we've partnered with a homeland security and business consultancy, Eminent Logic, to help penetrate into the Middle Eastern markets. In return, we introduce them to local companies we know that can further their business objectives.

Network:

Alternative business development strategies include attending, sponsoring, and participating in industry networking events and conferences. Look into joining industry associations that have a footprint in your target markets, or that are native to the target market. Web-based networking groups (e.g. LinkedIn) can also help expand your network.

Market:

Now that you've built out your infrastructure, trained and deployed a team, and modified your offering and marketing collateral, you're ready to turn on the fire hose. Two of the most effective forms of outreach are search engine and email marketing. Internet access is everywhere, which means everyone has access to search engines and email. The best way to build a house list of potential customers in your target market is to optimize your international Web site for search engines and offer visitors an incentive to provide their email address. Once you've got their permission to contact them regularly, build a relationship and convert site visitors and email subscribers into customers.

Travel:
Over time, cold leads will become hot, and those hot leads will want face-to-face meetings. Its decision time: are you ready to invest in a global travel expense account? If so, be prepared to reel in the business, as most of the world works on a handshake and face time is critical. Turn your business trips into tax-deductible vacations and see the world while you're at it.

INTERNATIONAL INVESTMENT DECISION MAKING

Direct investors tend to look at a number of factors relating to how they will be able to operate in a foreign country:

- the rules and regulations pertaining to the entry and operations of foreign investors
- standards of treatment of foreign affiliates, compared to "nationals" of the host country
- the functioning and efficiency of local markets
- trade policy and privatization policy
- business facilitation measures, such as investment promotion, incentives, improvements in amenities and other measures to reduce the cost of doing business. For example, some countries set up special export processing zones, which may be free of customs or duties, or offer special tax breaks for new investors
- restrictions, if any, on bringing home ("repatriating") earnings or profits in the form of dividends, royalties, interest or other payments

The determinants of FPI are somewhat more complex, however. Because portfolio investment earnings are more likely to be tied to the broader macroeconomic indicators of a country, such as overall market capitalization of an economy, they can be more sensitive to factors such as:

- high national economic growth rates
- exchange rate stability
- general macroeconomic stability
- levels of foreign exchange reserves held by the central bank
- general health of the foreign banking system
- liquidity of the stock and bond market
- interest rates

In addition to these general economic indicators, portfolio investors also look at the economic policy environment as well, and especially at factors such as:

- the ease of repatriating dividends and capital
- taxes on capital gains
- regulation of the stock and bond markets
- the quality of domestic accounting and disclosure systems
- the speed and reliability of dispute settlement systems
- the degree of protection of investor's rights

Foreign Exchange Rate

A (foreign) exchange rate is the rate at which one currency is exchanged for another. Thus, an exchange rate can be regarded as the price of one currency in terms of another. An exchange rate is a ratio between two monies. If 5 UK pounds or 5 US dollars buy Indian goods worth Rs. 400 and Rs. 250 then pound-rupee or dollar-rupee exchange rate becomes Rs. 80 = £1 or Rs. 50 = $1, respectively. Exchange rate is usually quoted in terms of rupees per unit of foreign currencies. Thus, an exchange rate indicates external purchasing power of money.

A fall in the external purchasing power or external value of rupee (i.e., a fall in the exchange rate, say for Rs. 80 = £1 to Rs. 90 = £1) amounts to depreciation of the Indian rupee. Consequently, an appreciation of the Indian rupee occurs when there occurs an increase in the exchange rate from the existing level to Rs. 78 = £1. In other words, the external value of rupee rises. This indicates strengthening of the Indian rupee. Conversely, the weakening of the Indian rupee occurs if external value of rupee in terms of pound falls.

Foreign Exchange Risk

Foreign exchange risk (also known as **exchange rate risk** or **currency risk**) is a financial risk posed by an exposure to unanticipated changes in the exchange rate between two currencies.[1][2] Investors and multinational businesses exporting or importing goods and services or making foreign investments throughout the global economy are faced with an exchange rate risk which can have severe financial consequences if not managed appropriately.

Types of Exposure

- **Transaction Exposure**

A firm has *transaction exposure* whenever it has contractual cash flows (receivables and payables) whose values are subject to unanticipated changes in exchange rates due to a contract being denominated in a foreign currency. To realize the domestic value of its foreign-denominated cash flows, the firm must exchange foreign currency for domestic currency. As firms negotiate
contracts with set prices and delivery dates in the face of a volatile foreign exchange market with exchange rates constantly fluctuating, the firms face a risk of changes in the exchange rate between the foreign and domestic currency

- **Economic Exposure**

A firm has *economic exposure* (also known as *operating exposure*) to the degree that its market value is influenced by unexpected exchange rate fluctuations. Such exchange rate adjustments can severely affect the firm's market share| position with regards to its competitors, the firm's future cash flows, and ultimately the firm's value. Economic exposure can affect the present value of future cash flows. Any transaction that exposes the firm to foreign exchange risk also exposes the firm economically, but economic exposure can be caused by other business activities and investments which may not be mere international transactions, such as future cash flows from fixed assets. A shift in exchange rates that influences the demand for a good in some country would also be an economic exposure for a firm that sells that good.

- **Translation Exposure**

A firm's *translation exposure* is the extent to which its financial reporting is affected by exchange rate movements. As all firms generally must prepare consolidated financial statements for reporting purposes, the consolidation process for multinationals entails translating foreign asset]s and liabilities or the financial statements of foreign subsidiary subsidiaries from foreign to domestic currency. While translation exposure may not affect a firm's cash flows, it could have a significant impact on a firm's reported earnings and therefore its stock price. Translation exposure is distinguished from transaction risk as a result of income and losses from various types of risk having different accounting treatments.

- **Contingent exposure**

- A firm has *contingent exposure* when bidding for foreign projects or negotiating other contracts or foreign direct investments. Such an exposure arises from the potential for a firm to suddenly face a transactional or economic foreign exchange risk, contingent on the outcome of some contract or negotiation. For example, a firm could be waiting for a project bid to be accepted by a foreign business or government that if accepted would result
in an immediate receivable. While waiting, the firm faces a contingent exposure from the uncertainty as to whether or not that receivable will happen. If the bid is accepted and a receivable is paid the firm then faces a transaction exposure, so a firm may prefer to manage contingent exposures.

Factors affecting Exchange Rates

1. Inflation Rates

Changes in market inflation cause changes in currency exchange rates. A country with a lower inflation rate than another's will see an appreciation in the value of its currency. The prices of goods and services increase at a slower rate where the inflation is low. A country with a consistently lower inflation rate exhibits a rising currency value while a country with higher inflation typically sees depreciation in its currency and is usually accompanied by higher interest rates.

2. Interest Rates

Changes in interest rate affect currency value and dollar exchange rate. Forex rates, interest rates, and inflation are all correlated. Increases in interest rates cause a country's currency to appreciate because higher interest rates provide higher rates to lenders, thereby attracting more foreign capital, which causes a rise in exchange rates

3. Country's Current Account / Balance of Payments

A country's current account reflects balance of trade and earnings on foreign investment. It consists of total number of transactions including its exports, imports, debt, etc. A deficit in current account due to spending more of its currency on importing products than it is earning through sale of exports causes depreciation. Balance of payments fluctuates exchange rate of its domestic currency.

4. Government Debt

Government debt is public debt or national debt owned by the central government. A country with government debt is less likely to acquire foreign capital, leading to inflation. Foreign investors will sell their bonds in the open market if the market predicts government debt within a certain country. As a result, a decrease in the value of its exchange rate will follow.

5. Terms of Trade

Related to current accounts and balance of payments, the terms of trade is the ratio of export prices to import prices. A country's terms of trade improves if its exports prices rise at a greater rate than its imports prices. This results in higher revenue, which causes a higher demand for the country's currency and an increase in its currency's value. This results in an appreciation of exchange rate.

6. Political Stability & Performance

A country's political state and economic performance can affect its currency strength. A country with less risk for political turmoil is more attractive to foreign investors, as a result, drawing investment away from other countries with more political and economic stability. Increase in foreign capital, in turn, leads to an appreciation in the value of its domestic currency. A country with sound financial and trade policy does not give any room for uncertainty in value of its currency. But, a country prone to political confusions may see a depreciation in exchange rates.

7. Recession

When a country experiences a recession, its interest rates are likely to fall, decreasing its chances to acquire foreign capital. As a result, its currency weakens in comparison to that of other countries, therefore lowering the exchange rate.

8. Speculation

If a country's currency value is expected to rise, investors will demand more of that currency in order to make a profit in the near future. As a result, the value of the currency will rise due to the increase in demand. With this increase in currency value comes a rise in the exchange rate as well.

Determination of Exchange Rate:

Now two pertinent questions that usually arise in the foreign exchange market are to be answered now. First, how is the equilibrium exchange rate determined, and secondly, why does exchange rate move up and down?

There are two methods of foreign exchange rate determination. One method falls under the classical gold standard mechanism and another method falls under the classical paper currency system. Today, gold standard mechanism does not operate since no standard monetary unit is now exchanged for gold. All countries now have paper currencies not convertible to gold.

Under inconvertible paper currency system, there are two methods of exchange rate determination. The first is known as the purchasing power parity theory and the second is known as the demand-supply theory or the balance of payments theory. Since today there is no believer of purchasing power parity theory, we consider only demand-supply approach to foreign exchange rate determination.

Demand-Supply Approach of Foreign Exchange:

Or, BOP Theory of Foreign Exchange Rate Determination:

Since the foreign exchange rate is a price, economists apply supply-demand conditions of price theory in the foreign exchange market. A simple explanation is that the rate of foreign exchange equals its supply. For simplicity, we assume that there are two countries: India and the USA. Let the domestic currency be rupee.

The US dollar stands for foreign exchange and the value of rupee in terms of dollars (or conversely, the value of dollars in terms of rupee) stands for foreign exchange rate. Now the value of one currency in terms of another currency depends upon the demand for and the supply of foreign exchange.

Demand for Foreign Exchange:

When Indian people and business firms want to make payments to the US nationals for using US goods and services or to make gifts to the US citizens or to buy assets there, the demand for foreign exchange (here dollar) is generated. In other words, Indians demand or buy dollars by paying rupee in the foreign exchange market. A country releases its foreign currency for buying imports. Thus what appears in the debit side of the BOP account are the sources of demand for foreign exchange. Larger the volume of imports, greater is the demand for foreign exchange.

The demand curve for foreign exchange is negative sloping. A fall in the price of foreign exchange or a fall in the price of dollar in terms of rupee (i.e., dollar depreciates) means that foreign goods are now more cheaper. Thus, an Indian could buy more American goods at a low price. Consequently, imports from the USA would increase—resulting in an increase in the demand for foreign exchange, i.e., dollar.

Conversely, if the price of foreign exchange or the price of dollar rises (i.e., dollar appreciates) foreign goods will now be expensive leading to a fall in import demand and, hence, fall in the demand for foreign exchange. Since price of foreign exchange and demand for foreign exchange move in opposite directions, the importing country's demand curve for foreign exchange is downward sloping from left to right.

In Fig. 6.6, DD_1 is the demand curve for foreign exchange. In this figure, we measure exchange rate expressed in terms of domestic currency that costs 1 unit of foreign currency (i.e., dollar per rupee) on the vertical axis. This makes the demand curve for foreign exchange negative sloping. If the exchange rate is expressed in terms of foreign currency that could be purchased with a 1 unit of domestic currency (i.e., dollar per rupee), the demand curve would exhibit positive slope. Here we have chosen the former one.

✓ Measurement

- If foreign exchange markets are efficient such that purchasing power parity, interest rate parity, and the international Fisher effect hold true, a firm or investor needn't protect against foreign exchange risk due to an indifference toward international investment decisions. A deviation from one or more of the three international parity conditions generally needs to occur for an exposure to foreign exchange risk. Financial risk is most commonly measured in terms of the variance or standard deviation of a variable such as percentage returns or rates of change. In foreign exchange, a relevant factor would be the rate of change of the spot exchange rate between currencies. Variance represents exchange rate risk by the spread of exchange rates, whereas standard deviation represents exchange rate risk by the amount exchange rates deviate, on average, from the mean exchange rate in a probability distribution. A higher standard deviation would signal a greater currency risk. Economists have criticized the accuracy of standard deviation as a risk indicator for its uniform treatment of deviations, be they positive or negative, and for automatically squaring deviation values. Alternatives such as average absolute deviation and semi variance have been advanced for measuring financial risk.

✓ **Value at Risk**

- Practitioners have advanced and regulators have accepted a financial risk management technique called value at risk (VAR), which examines the tail end of a distribution of returns for changes in exchange rates to highlight the outcomes with the worst returns. Banks in Europe have been authorized by the Bank for International Settlements to employ VAR models of their own design in establishing capital requirements for given levels of market risk. Using the VAR model helps risk managers determine the amount

that could be lost on an investment portfolio over a certain period of time with a given probability of changes in exchange rates.

Management

Foreign exchange hedge

- Managers of multinational firms employ a number of foreign exchange hedging strategies in order to protect against exchange rate risk. Transaction exposure is often managed either with the use of the money markets, foreign exchange derivatives such as forward contracts, futures contracts, options, and swaps, or with operational techniques such as currency invoicing, leading and lagging of receipts and payments, and exposure netting. Firms may exercise alternative strategies to financial hedging for managing their economic or operating exposure, by carefully selecting production sites with a mind for lowering costs, using a policy of flexible sourcing in its supply chain management, diversifying its export market across a greater number of countries, or by implementing strong research and development activities and differentiating its products in pursuit of greater inelasticity and less foreign exchange risk exposure.

- Translation exposure is largely dependent on the accounting standards of the home country and the translation methods required by those standards. For example, the United States Federal Accounting Standards Board specifies when and where to use certain methods such as the temporal method and current rate method. Firms can manage translation exposure by performing a balance sheet hedge. Since translation exposure arises from discrepancies between net assets and net liabilities on a balance sheet solely from exchange rate differences. Following this logic, a firm could acquire an appropriate amount of exposed assets or liabilities to balance any outstanding discrepancy. Foreign exchange derivatives may also be used to hedge against translation exposure.

UNIT-V

SELECTION OF EXPATRIATE MANAGERS:

An expatriate (often shortened to expat) is a person temporarily or permanently residing in a country other than that of the person's upbringing. The word comes from the Latin terms ex ("out of") and patria ("country, fatherland"). In common usage, the term is often used in the context of professionals or skilled workers sent abroad by their companies, rather than for all 'immigrants' or 'migrant workers'. The differentiation found in
common usage usually comes down to socio-economic factors, so skilled professionals working in another country are described as expatriates, whereas a manual laborer who has moved to another country to earn more money might be labeled an 'immigrant' or 'migrant worker'. There is no set definition and usage varies with context, for example the same person may be seen as an "expatriate" by their home country and a "migrant worker" where they work. Retirement abroad, in contrast, usually makes one an "expatriate".

Phase of the International HRM

- Selection – By focusing on selection criterions and characteristics of the expatriates.
- Training – Prepare the expatriate for the international assignment.
- Arrival and Support – Period where the expatriate learn to adjust to new behaviors, norms, values and assumptions.
- Repatriation – How to prepare the expatriate and his/her spouse and family to re- turn to the home country.

Expatriation

- A fundamental challenge faced by multinational companies today is how to ensure that managers develop not only an overview of the organization in its entirety, but also a feel for international business (Gooderham & Nordhaug, 2003).
- Due to globalization, in order to stay resistant in the increasing competing global market, it is important to train the em-ployee to become international minded.
- As Briscoe and Schuler (2004) say, the health of today's multinational companies is the function of International Human Resource Man-agement's ability to match the firms' workforce forecast with the supply of global talent.
- "People that are living and working in a non-native country"
- The first definition put emphasize of not being born in the specific country whereas in the second definition the expatriate does not need to be born in the country he/she considers to be his/her home country.
- The last definition describes an expatriate that works in a country which he/she is not a citizen. Since we believe that these three definitions differ from each other, we have

- "An expatriate is an employee that is temporarily working and living in a country or region that is not his or her home country".

The Three Faces of Expatriation

- Dowling and Welch (2004) define PCNs as employees, in the parent company, that are transferred to a host country subsidiary. PCN's role today is changing. Evans et al. (2002) state that traditional expatriates was sent abroad only to fix a problem or control the foreign organization.
- Today, more and more companies recognize that cross-border mobility is a potential learning toll, thus it increases the number of assignments in which the primary drive is to support individual or organizational learning.
- Except for PCNs, there are two more kinds of employees that are considered to be expatriates, namely:
    - o Host - Country Nationals (HCN) and
    - o Thi - Country Nationals (TC from the host subsidiary to the parent company. TCN are

employees sent from one foreign subsidiary to another foreign subsidiary that are both owned by the same parent company (Dowling & Welch, 2004).

- For example, the Swedish multinational company employs Chinese citizens in its Swedish operations (HCNs), or a Swedish company sends some of its Japanese employees on assignment to China (TCNs). Below in Figure 2-1 is an illustration by Dowling and Welch (2004) on the different kind of expatriates created by international assignments.

- As stated in the purpose, our research will only be focused upon gaining an understanding of how three Swedish multinational companies select and train their Parent-Country Na- (PCN) expatriates before the international assignment in China. Therefore, when we refer to the word expatriate in the rest of this thesis will automatically refer to PCN expatriate.

- The reason why we chose to look upon PCN expatriate is because, today it is still the most common way to send an employee to work in a foreign environment. A PCN expatriate does not only help the head quarter to bring in new knowledge, but also transfer new ways of doing things to the subsidiaries (Evans et al., 2002).

Motives and Roles of Expatriation

- After having decided that PCN expatriates are the most suitable employees for us to look at we will now describe the different roles that an expatriate can take and the motives behind it. Dowling and Welch (2004) have identified several reasons for using expatriates.

1. **Agent of Socialization:**

- The person that performs the task knows and is familiar with the "values and beliefs" of the parent firm. Dowling and Welch (2004) call the transfer of values and beliefs socialization. An example is that the parent firm has values and beliefs, visions and strategies that they want to communicate through the whole organization. The best way to transfer these factors is through someone that has a clear understanding of the parent company.

2. **Network Builder**

- International assignments are viewed as a way of conducting interpersonal linkages that can be used for informal control and communication purposes. An expatriate that works as a network builder will possess knowledge that is of value for the company. Knowing people from different key positions and what they need as well as these people know what the expatriate is credible for, when performing a task, there is a mutual dependence between both parts (Dowling & Welch, 2004).

3. **Agent of Direct Control**

- The parent company wants to have an overview and con-trol over the host company (Ström, Bergren, Carle & Polgren, 1995).
- The use of expatriate in this context can be regarded as a bureaucratic control mechanism since the primary role is to ensure compliance through direct supervision (Dowling & Welch, 2004).

Boundary Spanners:

- Boundary Spanning refers to the activities that an expatriate conduct, such as gathering information that bridge internal and external organizational contexts.
- Visiting the foreign country, the expatriate has the function to promote its own firm to a high level but also at the same time able to collect host country information.
- The expatriate will also have the opportunity to gather mar-kets intelligence for the firm (Dowling & Welch, 2004).

Expatriate Failure

- Expatriate failure is a term that is defined as the premature return of an expatriate which means that the expatriate is returning home before completing the assignment.
- If the expatriate remains during the whole assignment and have done what was intended, the assignment will then count as a success.
- Today, expatriate failure rate is between 25 and 40 percent of when an expatriate is as- signed a task in a developed country compared with 70 percent in still developing coun- tries (Shay & Tracey, 1997).

Culture

- Every country has at least some differences compared with other countries, e.g., its history, government and laws (Briscoe & Shuler, 2004).
- There are distinguishable differences between cultures such as in how a person dress and behaves but also discrete differences such as values and beliefs (Harzing & Ruysseveldt, 2004).
- Today, it is generally recognized that culturally insensitive attitudes and behaviors stemming from ignorance or from misguided beliefs not only are inappropriate, but often cause international business failure (Dowling & Welch, 2004).

- Managers, as well as the people they work with, are part of national societies. If the managers want to understand the behavior of people in a different culture, they have to understand their society (Hofstede & Hofstede, 2005).
- Multinational companies need to learn to cope internationally with issues like selecting and preparing people for working and managing in other countries, how to negotiate and con- duct businesses in a foreign country, to be able to capitalize and absorb the learning throughout the international operations. In order to succeed in these activities, one has to understand the effects of culture on day-to-day business operations (Briscoe & Shuler, 2004).
- The cultural aspects of this thesis will only be dealt in a general level with the aim to make the reader aware of the contrast between Sweden and China.

Selection

- Today, research within how to select an expatriate is heavily oriented.
- According to Evans et al. (2002) this has led to lists of competences and characteristics that an expatriate should have. Selection is thus about how to make a fair and relevant choice among the applicants by accessing their strengths and weaknesses (Boxall & Purcell, 2003).

Selection Criterions

- A lot of research has focused on understanding selection criterions (Evans et al., 2002).
- According to Briscoe and Schuler (2004) errors in the selection process can have a negative impact on the success of an organization's overseas operations and therefore it is crucial to select the right person for the assignment.
- Dowling and Welch (2004) have identified six criterions that a manager evaluates when selecting an employee for an international assignment, they are:

Welch, 2004).

 However, past performance has little or no bearing on how the candidate will perform in a different culture (Dowling & Welch, 2004).

Cross-Cultural Suitability –

- Allows the candidate to operate in a new culture. Some of the abilities that should be included are; cultural empathy, adaptability, diplomacy, language Situation Individual i emotional stability, and maturity.
- Even though cross-cultural abilities are said to be important, very few senior managers will actually test the candidate for these, since they are difficult to determine.
- Even if a candidate possess a number of cross-cultural abilities the candidate's personality might still make him/her unsuitable for international assignments, for instance; attitude towards foreigners, and the inability to relate to people from another cultural group (Dowling & Welch, 2004).

Family Requirements –

- Since the candidate might have a family which he/she needs to take into consideration, such as; the spouse/partner especially in dual-career families, the adolescent children especially considering schooling, health issues, dependent parents, and psychological difficulties like for instance phobia of flying (Briscoe & Schuler, 2004).
- Gooderham and Nordhaug (2003) refers to Tung (1982) who in a study on expatriate failure of American, Japanese, and European expatriates shows that not only is the inability of the spouse to adjust the number one reason among the Americans, it is also the only consistent reason among the European expatriate.
- The spouse/partner might not work during the international assignment however, their workload is quite extensive, starting with settling the family into the new home, and perhaps even employing servants, caring for the wellbeing as well as arranging with the schooling for the children, and all of this comes at a time when the spouse/partner has left their career behind them as well as their friends and relatives (Dowling & Welch, 2004).

Country/Cultural Requirements –

- It may sometimes be difficult for the companies to get work permits for their expatriate, not to mention their spouse, which may in a dual career relationship add hardship on the expatriate and hence, increasing the risk of expatriate failure.
- Also it seems that some companies prefer not to send women to certain conservative countries or regions, such as parts of the Middle East and South East Asian (Dowling & Welch, 2004).
- Although this is common among companies, research has shown that even in traditionally male dominated countries, such as Japan and Korea, female expatriates do as good as the male ones. In fact, the locals sees a female expatriate as a representative for the company first, a foreigner second and as a women third (Stroh et al., 2004).
- Lastly, it is also important that the company keeps up-to-date on the legislation in the countries that they operate in (Dowling & Welch, 2004).

The Multinational Enterprise (MNE) Requirements –

- A company might try to keep a certain proportion of expatriates compared to their local staff, hence choosing to hire Host Country Nationals (HCN) instead.

Language –

 The ability to speak a local language is considered to be more important in some countries than others. For instance in certain countries using an interpreter may be a much better choice since learning that language would take to long. Since there is a risk

that a candidate might be removed from the pool of possible expatriates because of lack of speaking the language, the company might oversee a person whom would have been per- fect for the job, and hence increase the risk of failure for the company (Dowling & Welch, 2004).

- Dowling and Welch (2004) believes that technical ability, cross-cultural suitability, and fam- ily requirements are all based upon the individual meanwhile country/cultural require- ments, language and multinational company requirements are different depend on the host country and culture. Companies usually choose to hire their expatriates from

  within the or-ganization since it is generally easier for the company to observe an individual's ability and efforts that is already employed, compared with a candidate from an external job market (Baron & Kreps, 1999).

Competences of an Expatriate

- Another way for firms to avoid the phenomenon of expatriate failure is to select expatriate, with their families, that will be most able to adapt overseas and also at the same time pos- sess the necessary skills to have the job done in the foreign environment (Briscoe & Shuler, 2004).
- According to Schneider and Barsoux (1997) there are nine competences that are sig- nificant for an expatriate in order to cope with differences abroad, they are:

Interpersonal Skills –

- An expatriate needs to be able to form relationships so that they can integrate into the social fabric of the host country.
- Thus, satisfying both the personal need for friendship and intimacy, as well as smoothing the progress of transferring knowledge, and improving coordination and control between the parental company and the host subsidiary.

Linguistic Ability –

- Is a competence that helps the expatriate in establishing contact with the locals. Having total command of the language is not necessary, however efforts to speak the language, even if only parts of local phrases, shows that the expatriate is making a symbolic effort to communicate and to connect with the host nationals. The opposite, a resolute unwillingness to speak the language may be seen as a sign of contempt to the host nationals.

Motivation to Work and Live Abroad

- This has shown to be important in order for the expatriate and his/her family to successfully adapt to the new culture. Selecting expatriates and their families should be based on a genuine interest in new experiences and other cultures.

Ability to Tolerate and Cope with Uncertainty –

- Since circumstances might unexpectedly change, or that the behaviors and reactions of the local employees may be unpredictable, the expatriate needs to be able to show the capability of quick adaptation to the new situation. It is good if the expatriate knows, in advance, that uncertainty and ambiguity exists, that people might have different perspectives, and that not everything is as straight-forward as it might appear (Schneider & Barsoux, 1997).

Flexibility –

- When something unexpected occurs, the expatriate might need to let go of the control, in order to let the company adapt to the event and use it as an opportunity to grow. This may be especially difficult, since managers are generally rewarded for staying on top of things.

Patience and Respect –

- The expatriate needs to remember that different cultures have other ways of doing things, which is why patience is so important when dealing with a new culture.

- An expatriate needs to be careful so that he/she does not always use their own culture as a benchmark for the new culture, but instead try to make sense of the reasoning be-hind the way the locals think and act. Patience and respect is the golden rule of international business, but it seems that this rule is the one to be most often broken.

Cultural Empathy –

- An expatriate should be able to respect the ideas, values, and behav-iors of others. Listening with a non-judgmental approach helps the expatriate understand the thoughts, feelings, and experiences of the locals. However, this ability is deeply rooted in a person's characteristics and may not be acquired easily.

Strong Sense of Self (ego strength) –

- Having a strong sense of self enables a person to in-teract with other cultures without losing one's own identity, as well as allowing the expatri-ate to be self-critical and open to feedback. It also makes the expatriate treat failures as a learning experience and not as an injury to their self-image, which would undermine their self-confidence. When the expatriate has a strong ego, the ability to handle stress becomes better.

A Sense of Humor –

- Is needed for two reasons. Firstly, it is a way to deal with frustration, uncertainty, and confusion that the expatriate might encounter. It also helps him/her distancing from the situation, in order to regain some perspective. Secondly, if used correctly humor can work as an ice breaker, a way of establishing a relationship with others. Or, it can be used to put people at ease, to break the tension, and allow a more open and constructive discussion.

- Having gained an understanding of the different criterions that firms use and the different competences that an expatriate can possess, the next step is to use different selection tools, and based on the selection criterions; find the appropriate expatriate for the international assignment.

The Different Selection Processes

- Today, organizations rely on different procedures in their selection of individuals for international assignments. There are, according to Briscoe and Schuler (2004), a number of procedures to choose from when selecting an expatriate.

Interviews –

- According to Briscoe and Schuler (2004) interviews with the candidate and possibly his/her spouse should be conducted in order to find out if they have the ability to adjust to the foreign culture. The interview in itself should be focused on the candidate's past behaviors that might provide evidence of the presence or absence of the characteristics the interviewer favor (Stroh et al., 2004). Interviews can be most useful when assessing a candidate's communication and interpersonal skills, and also, sometimes, general intelligence.

Formal Assessment Tests –

- Evaluates the candidate's personal traits found to be important in adjusting to the new culture; these include adaptability, flexibility, a liking for new experiences, and good interpersonal skills (Briscoe & Schuler, 2004).

- Testing to see if the candidate has competences related to managing diversity is as important if not more important than the candidate's t Is another reason for multinational companies to send an individual for an international assignment. Managers see that international assignment may be a step for an employee in

his/her career development (Briscoe & Schuler, 2004).

Self-Selection –

- Many multinational companies use one or more of the above processes. However, at the end it is usually up to the candidate to decide if he/she is ready or have the necessary skills, experiences, or attitudes to go on an international assignment (Briscoe & Schuler 2004).
- It is as important for the expatriate as it is for the company that he/she fits the assignment in question since the expatriate would suffer from a bad fit. The general idea is that the longer a worker is happily employed, the greater will the worker's commit-ment and loyalty to the firm be (Baron & Kreps, 1999).

Training of the Expatriate

- Once an employee has been selected for an expatriate position, pre-departure training is considered to be the next critical step in attempting to ensure that the expatriate's effectiveness and success abroad, especially where the destination country is considered to be culturally tough (Dowling & Welch, 2004).

- It is said that good preparation can go a long way to reduce the time it takes to adjust to the new environment (Evans et al., 2002).

- Strong evidence shows that pre-departure cross-cultural training reduces expatriate failure rates and increases expatriate job performances (Cullen & Parboteeah, 2004).

- Evans et al. (2002) describe three main issues that concern training and development of the expatriates. The first one concerns the different *training methods*, second the timing of training and the third issue concerns preparing the spouse and family when accompanying the expatriate during the international assignment.

(1) Preparatory training for expatriates: once a person has been appointed for an international assignment, pre-departure training is normally used to ensure the candidate has adequate skills and knowledge that are necessary for working abroad effectively.
(2) Post-arrival training for expatriates: after an expatriate has gone abroad, further on-site training is often used to familiarize the expatriate with the local working environment and procedures.
(3) Training for host-country nationals (HCNs) and third-country nationals (TCNs): Training should be provided to HCNs and TCNs to facilitate understanding of corporate strategy, corporate culture and socialization.
(4) Preparatory training for expatriates has received most attention in the international literature as expatriate failure (i.e. the premature return of an expatriate manager before the period of

Training Methods

According to Dowling and Welch (2004), studies indicate that the essential components of pre-departure training programs that contribute to a smooth transition to a foreign location include Cross-Cultural Training (CCT), preliminary visits, language training and assistance with practical day-to-day matters.

Cross-Cultural Training

It is generally accepted that, to be effective, the expatriate employee must adapt to

- Become aware that behaviors differ across cultures and the importance of observing these cultural differences carefully.

- Build cognitive cultural maps so that expatriates understand why the local people value certain behaviors, how these appear to be and how these can be appropriately reproduced.

- Practice the behaviors they will need to reproduce in order to be efficient in their international assignments.

- The processes mentioned above reflect back upon the importance for expatriates to be able to deal with cultural differences that he/she may confront. It builds the foundation of de-signing cross-cultural training for the managers (Stroh et al., 2004).

- According to Stroh et al. (2004), Evans et al. (2002) as well as Dowling and Welch (2004), the success factor of a training program is the level of rigor of the training.

- Stroh et al. (2004) state that rigor is the degree of mental involvement and effort that the trainer and the trainee need to get use of in order for the trainee to learn the required concepts.

Rigor Training (information giving approach) –

- Training that last for a short period of time and includes activities such as area briefings and cultural briefings (lectures), watching videos, reading books and language training at a survival level.

Moderate Rigor Training (affective approach) –

The training last about 4 weeks and con-tain activities such as culture assimilator training, role playing, cases, stress reduction train-ings and moderate language training.

High Rigor Training (immersion approach) –

Are often planned to endure more than a month and it contains more experimental training such as assessment centers, field experiments (the employee is sent to work abroad for a short period of time), simulations, sensitivity training as well as extensive language training.

ADVANTAGES DISADVANTAGES OF INTERNATIONAL BUSINESS:

Though international business are most important for a country's economy but there are some advantages and disadvantages of international business which are described in detail below Following are the advantages of international business:

1. **Earning valuable foreign currency:** A country is able to earn valuable foreign currency by exporting its goods to other countries.
2. **Division of labor:** International business leads to specialization in the production of goods. Thus, quality goods for which it has maximum advantage.
3. **Optimum utilization of available resources:** International business reduces waste of national resources. It helps each country to make optimum use of its natural resources. Every country produces those goods for which it has maximum advantage.
4. **Increase in the standard of living of people:** Sale of surplus production of one country to another country leads to increase in the incomes and savings of the people of the former country. This raises the standard of living of the people of the exporting country.
5. **Benefits to consumers:** Consumers are also benefited from international business. A variety of goods of better quality is available to them at reasonable prices. Hence,

6. **Encouragement to industrialization:** Exchange of technological know-how enables underdeveloped and developing countries to establish new industries with the assistance of foreign aid. Thus, international business helps in the development of industry.

7. **International peace and harmony:** International business removes rivalry between different countries and promotes international peace and harmony. It creates dependence on each other, improves mutual confidence and good faith.

8. **Cultural development:** International business fosters exchange of culture and ideas between countries having greater diversities. A better way of life, dress, food, etc. can be adopted form other countries.

9. **Economies of large-scale production:** International business leads to production on a large scale because of extensive demand. All the countries of the world can obtain the advantages of large-scale production.

10. **Stability in prices of products:** International business irons out wide fluctuations in the prices of products. It leads to stabilization of prices of products throughout the world.

11. **Widening the market for products:** International business widens the market for products all over the world. With the increase in the scale of operation, the profit of the business increases.

12. **Advantageous in emergencies:** International business enables us to face emergencies. In case of natural calamity, goods can be imported to meet necessaries.

13. **Creating employment opportunities:** International business boosts employment opportunities in an export-oriented market. It raises the standard of living of the countries dealing international business.

14. **Increase in Government revenue:** The Government imposes import and export duties for this trade. Thus, Government is able to earn a great deal of revenue from international business.

15. Other advantages:

- Effective business education
- Improvement in production systems.
- Elimination of monopolies, etc.

DISADVANTAGES OF INTERNATIONAL BUSINESS ARE AS FOLLOWS:

1. **Adverse effects on economy:** One country affects the economy of another country through international business. Moreover, large-scale exports discourage the industrial development of importing country. Consequently, the economy of the importing country suffers.

2. **Competition with developed countries:** Developing countries are unable to compete with developed countries. It hampers the growth and development of developing countries, unless international business is controlled.

3. **Rivalry among nations:** Intense competition and eagerness to export more commodities may lead rivalry among nations. As a consequence, international peace may be hampered.

4. **Colonization:** Sometimes, the importing country is reduced to a colony due to economic and political dependence and industrial backwardness.

5. **Exploitation:** International business leads to exploitation of developing countries the developed countries. The prosperous and dominant countries regulate the economy poor nations.

6. **Legal problems:** Varied laws regulations and customs formalities followed different countries, have a direct b earring on their export and import trade.

7. **Publicity of undesirable fashions:** Cultural values and heritages are not identical in all the countries. There are many aspects, which may not be suitable for our atmosphere

8. **Language problems:** Different languages in different countries create barriers to establish trade relations between various countries.

9. **Dumping policy:** Developed countries often sell their products to developing countries below the cost of production. As a result, industries in developing countries of the close down.

10. **Complicated technical procedure:** International business in highly technical and it has complicated procedure. It involves various uses of important documents. It required expert services to cope with complicate procedures at different stages.

11. **Shortage of goods in the exporting country:** Sometimes, traders prefer to sell their goods to other countries instate of in their own country in order to earn more profits. This results in the shortage of goods within the home country.

12. **Adverse effects on home industry:** International business poses a threat to the survival of infant and nascent industries. Due to foreign competition and unrestricted imports upcoming industries in the home country may collapse.

CONFLICT IN INTERNATIONAL BUSINESS:

CONFLICT

Conflict is actual or perceived opposition of needs, values and interests. A conflict can be internal (within oneself) e individuals). Conflict as a concept can help explain many aspects of social life such as social disagreement, conflicts of interests, and fights between individuals, groups, or organizations. In political terms, "conflict" can refer to wars, revolutions or other struggles, which may involve the use of force as in the term armed conflict.

Key elements

o Interdependence with another party
o Perception of incompatible goals

Conflict events

o Disagreements
o Debates
o Disputes
o Preventing someone from reaching valued goals

Functional and Dysfunctional Conflict

Functional conflict: works toward the goals of an organization or group
Dysfunctional conflict: blocks an organization or group from reaching its goals
1. Dysfunctional high conflict: what you typically think about conflict
2. Dysfunctional low conflict: A typical view. Levels vary among groups

Functional conflict

 “Constructive Conflict”
 Increases information and ideas
Encourages innovative thinking
 Unshackles different points of view
 Reduces stagnation

Dysfunctional high conflict

 Tension, anxiety, stress
 Drives out low conflict tolerant people
 Reduced trust
 Poor decisions because of withheld or distorted information
 Excessive management focus on the conflict

Dysfunctional low conflict

 Few new ideas

- Poor decisions from lack of innovation and information
- Stagnation
- Business as usual

Conflict Management

Conflict management refers to the long-term management of intractable conflicts. It is the label for the variety of ways by which people handle grievances—standing up for what they consider to be right and against what they consider to be wrong. Those ways include such diverse phenomena as gossip, ridicule, lynching, terrorism, warfare, feuding, genocide, law, mediation, and avoidance. Which forms of conflict management will be used in any given situation can be somewhat predicted and explained by the social structure—or social geometry—of the case.

Types Of Conflict

- Community conflict
- Diplomatic conflict
- Environmental resources conflict
- External conflict
- Interpersonal conflict
- Organizational conflict
- Intra-societal conflict
- Military conflict
- Religious-based conflict
- Workplace conflict
- Relationship conflict

Conflict also defines as natural disagreement resulting from individuals or groups that differ in beliefs, attitudes, values or needs. It can also originate from past rivalries and personality differences. Other causes of conflict include trying to negotiate before the timing is right or before needed information is available.

Causes Of Conflict:

- Communication failure
- Personality conflict
- Value differences
- Goal differences
- Methodological differences
- Substandard performance
- Lack of cooperation
- Differences regarding authority
- Differences regarding responsibility
- Competition over resource
- Non-compliance with rules

Ways Of Addressing Conflict

- **Accommodating**: Individuals who enjoy solving the other party's problems and preserving personal relationships. Accommodators are sensitive to the emotional states, body language, and verbal signals of the other parties. They can, however, feel taken advantage of in situations when the other party places little emphasis on the relationship.
- **Avoiding:** Individuals who do not like to negotiate and don't do it unless warranted. When negotiating, avoiders tend to defer and dodge the confrontational aspects of negotiating; however, they may be perceived as tactful and diplomatic.

- **Collaborating**: Individuals who enjoy negotiations that involve solving tough problems in creative ways. Collaborators are good at using negotiations to understand the concerns and interests of the other parties. They can, however, create problems by transforming simple situations into more complex ones.
- **Competing**: Individuals who enjoy negotiations because they present an opportunity to win something. Competitive negotiators have strong instincts for all aspects of negotiating and are often strategic. Because their style can dominate the bargaining process, competitive negotiators often neglect the importance of relationships.
- **Compromising:** Individuals who are eager to close the deal by doing what is fair and equal for all parties involved in the negotiation. Compromisers can be useful when there is limited time to complete the deal; however, compromisers often unnecessarily rush the negotiation process and make concessions too quickly.

Counseling

When personal conflict leads to frustration and loss of efficiency, counseling may prove to be a helpful antidote. Although few organizations can afford the luxury of having professional counselors on the staff, given some training, managers may be able to perform this function. Nondirective counseling, or "listening with understanding", is little more than being a good listener—something every manager should be.

Conflict Resolution

Conflict resolution is a range of methods for alleviating or eliminating sources of conflict. The term "conflict resolution" is sometimes used interchangeably with the term dispute resolution or alternative dispute resolution. Processes of conflict resolution generally include negotiation, mediation, and diplomacy. The processes of arbitration, litigation, and formal complaint processes such as ombudsman processes, are usually described with the term dispute resolution, although some refer to them as "conflict resolution." Processes of mediation and arbitration are often referred to as alternative dispute resolution.

Methods Of Dispute Resolution Include:

1.lawsuits (litigation)
2.arbitration
3.collaborative law
4.mediation
5.conciliation
6.many types of negotiation
7.facilitation

One could theoretically include violence or even war as part of this spectrum, but dispute resolution practitioners do not usually do so; violence rarely ends disputes effectively, and indeed, often only escalates them. Some individuals, notably Joseph Stalin, have stated that all problems emanate from man, and absent man, no problems ensue. Hence, violence could theoretically end disputes, but alongside it, life.

Dispute resolution processes fall into two major types:

1. Adjudicative processes, such as litigation or arbitration, in which a judge, jury or arbitrator determines the outcome.
2. Consensual processes, such as collaborative law, mediation, conciliation, or negotiation, in which the parties attempt to reach agreement.

A LAWSUIT is a civil action brought before a court of law in which a plaintiff, a party who claims to have received damages from a defendant's actions, seeks a legal or equitable remedy. The defendant is required to respond to the plaintiff's complaint. If the plaintiff is successful, judgment will be given in the plaintiff's favor, and a range of court orders may be issued to enforce a right, award damages, or impose an injunction to prevent an act or compel an act.

ARBITRATION, a form of alternative dispute resolution (ADR), is a legal technique for the resolution of disputes outside the courts, wherein the parties to a dispute refer it to one or more persons (the "arbitrators", "arbiters" or "arbitral tribunal"), by whose decision (the "award") they agree

decision that is legally binding for both sides. Other forms of ADR include mediation (a form of settlement negotiation facilitated by a neutral third party) and non-binding resolution by experts.

COLLABORATIVE LAW (also called Collaborative Practice, Collaborative Divorce, and Collaborative Family Law) was originally a family law procedure in which the two parties agreed that they would not go to court, or threaten to do so.

MEDIATION, a form of alternative dispute resolution (ADR) or "appropriate dispute resolution", aims to assist two (or more) disputants in reaching an agreement. The partiesthemselves determine
the conditions of any settlements reached— rather than accepting something imposed by a third party. The disputes may involve (as parties) states, organizations, communities, individuals or other representatives with a vested interest in the outcome.

CONCILIATION is an alternative dispute resolution (ADR) process whereby the parties to a dispute (including future interest disputes) agree to utilize the services of a conciliator, who then meets with the parties separately in an attempt to resolve their differences. He does this by lowering tensions, improving communications, interpreting issues, providing technical assistance, exploring potential solutions and bringing about a negotiated settlement.

NEGOTIATION

Negotiation is a dialogue intended to resolve disputes, to produce an agreement upon courses of action, to bargain for individual or collective advantage, or to craft outcomes to satisfy various interests. It is the primary method of alternative dispute resolution.

Negotiation occurs in business, non-profit organizations, government branches, legal proceedings, among nations and in personal situations such as marriage, divorce, parenting, and everyday life.

ETYMOLOGY

The word "negotiation" is from the Latin expression, "negotiatus", past participle of negotiare which means "to carry on business". Another view of negotiation comprises 4 elements:

Strategy, process and tools, and tactics. Strategy comprises the top level goals - typically including relationship and the final outcome. Processes and tools include the steps that will be followed and the roles taken in both preparing for and negotiating with the other parties. Tactics include more detailed statements and actions and responses to others' statements and actions.

APPROACHES TO NEGOTIATION

The advocate's approach

In the advocacy approach, a skilled negotiator usually serves as advocate for one party to the negotiation and attempts to obtain the most favorable outcomes possible for that party. In this process the negotiator attempts to determine the minimum outcome(s) the other party is (or parties are) willing to accept, then adjusts their demands accordingly. A "successful" negotiation in the advocacy approach is when the negotiator is able to obtain all or most of the outcomes their party desires, but without driving the other party to permanently break off negotiations, unless the best alternative to a negotiated agreement (BATNA) is acceptable.

Indeed, the ten new rules for global negotiations advocated by Hernandez and Graham.

- Accept only creative outcomes
- Understand cultures, especially your own.
- Don‘t just adjust to cultural differences, exploit them.
- Gather intelligence and reconnoiter the terrain.
- Design the information flow and process of meetings.
- Invest in personal relationships.
- Persuade with questions. Seek information and understanding.
- Make no concessions until the end.
- Use techniques of creativity

Stages In The Negotiation Process.

Following are crucial steps to be followed in international negotiations to reach the final outcome:

1. Preparation

Proper preparation for your international negotiation requires studying in-depth material about the target culture and/or engaging a coach who commands extensive knowledge of the country and its business practices. Successful international negotiators never engage without careful preparation.

2. Set Objectives

It is important not to assume that the objectives of the foreign side will be identical with those you would expect in a domestic negotiation. Spending the time and effort to learn about them prior to engaging will give you a strong advantage.

3. Maintaining Relationships

Successful negotiations abroad usually require a lot of up-front relationship building. To varying degrees, people will want to learn about your company background and capabilities, prior experiences, strategies and objectives, long-term plans, and so on. They also want to get to know you personally before they decide to trust you. In several cultures, people don't want to conduct business with you unless you convinced them that you are seeking a long-term engagement rather than just 'pursuing a deal.'

4. Decision making authority

Since group decisions require a series of interactions between all stakeholders to form opinions and establish consensus, they cannot be made right at the negotiation table. Sufficient time needs to be given between negotiation rounds for the group to go through iterations of the process and reach their conclusions. Gaining insight into this process is difficult, so it is pivotal to identify relevant members of the group making the decision in order to try to influence each of them in your favor.

5. Techniques

People around the world are very creative when it comes to negotiating, bargaining, and haggling. Numerous negotiation techniques are used across the world. Some of them includes:

- Deception, False Demands, and False Concessions
- Extreme Openings
- Aggression and Strong Emotions
- Silence
- Best-Offer Pressure
- Time Pressure

6. Closure and Implementation

Once an agreement has been met, this is the stage in which procedures need to be developed to implement and monitor the terms of the agreement. They put all of the information into a format that's acceptable to both parties, and they formalize it.

Formalizing the agreement can mean everything from a handshake to a written contract.

Emotion In Negotiation

Emotions play an important part in the negotiation process, although it is only in recent years that their effect is being studied. Emotions have the potential to play either a positive or negative role in negotiation. During negotiations, the decision as to whether or not to settle rests in part on emotional factors. Negative emotions can cause intense and even irrational behavior, and can cause conflicts to escalate and negotiations to break down, while positive emotions facilitate reaching an agreement and help to maximize joint gains.

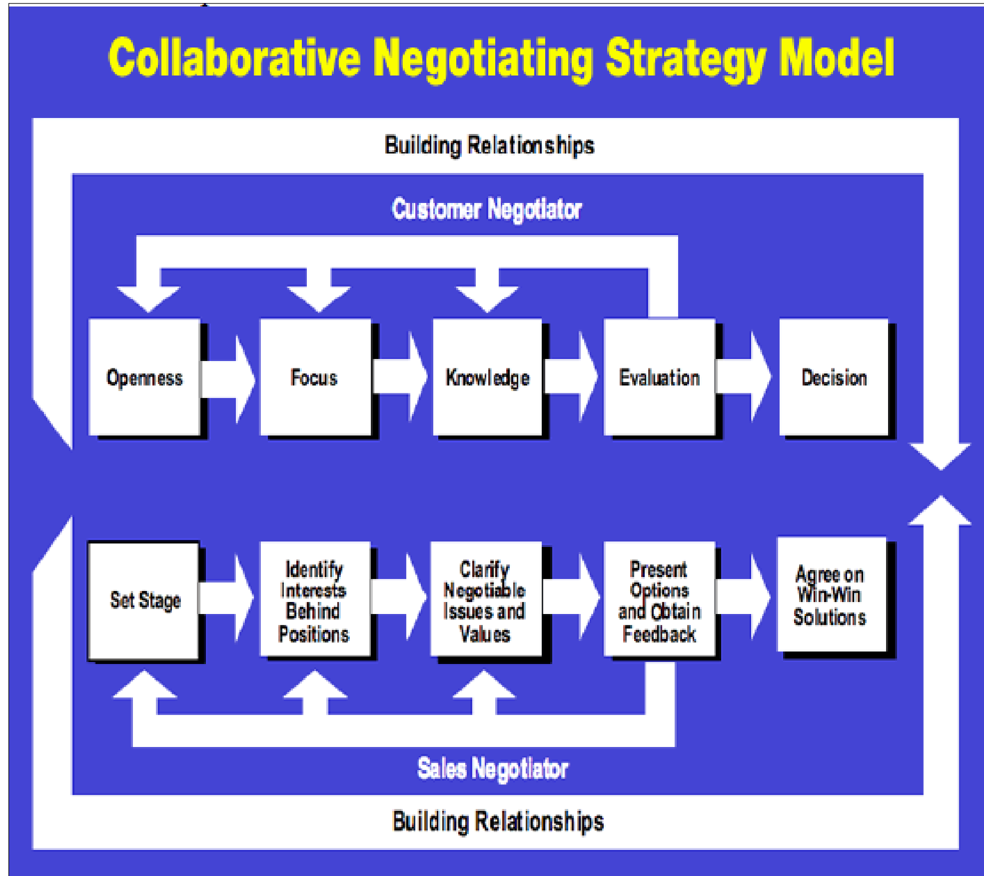
BASIC NEGOTIATION STRATEGIES:

Competitive

o The negotiation as a win-lose game

 Problem solving

o Search for possible win-win situations



	Demand	Offer	Threat
Who?	Who is to make decision	Who benefit if the decision is made	Who get hurt if the decision is not made
What?	Exactly what decision is desired	If the decision is made what benefit / costs can be expected	If the decision is not made what risk / potential benefits can be expected
When?	By what time does the decision have to be made	When if ever will the benefit of making the decision occur?	How soon will the consequences of not making the decision be felt
Why?	What makes this a right, proper & lawful decision?	What makes these consequences fair & legitimate	What make these consequences fair & legitimate

ROLE OF INTERNATIONAL AGENCIES:

1. The 'Hand-Shake'

Many New Zealand exporters confirm their agent or distributor's appointment and the terms of their relationship on the strength of a handshake. New Zealand Trade and Enterprise does not recommend this approach. If there is no written document the relationship can run into difficulties in areas such as measuring performance, sorting out differences of opinion, or terminating the arrangement. It is important to have a written agreement that covers the key components of your relationship.

2. Heads of Agreement/Exchange of Letters

In the majority of cases, a Heads of Agreement or Exchange of Letters is the best starting point in terms of an export and agent/distributor agreement. Such an agreement implies trust and a formal relationship and is a good mechanism to protect your interests. However, it does not involve the time and cost of working through lawyers. The Heads of Agreement should include the following:

- Products involved – description
- Territory covered by the representative
- The timeframe of the agreement
- Termination clauses – it is important to think about these at the start of the relationship
- when you and your representative are on good terms.
- Review Clauses – when you want to review the agreement and what you want to review
- Performance targets – these could cover such things as amount of sales, number of
- customers, number of advertising campaigns etc.

3. Formal Agent/Distributor Agreement

This is a formal agreement that requires the services of a lawyer, as well as considerable time and money on your behalf. Just as too many New Zealand exporters rely on the handshake agreement, too many also jump in at this stage. While the handshake is too flimsy, the formal agreement at the outset can be a waste of time and money if the relationship only lasts for a few months. It is usually better to start with a Heads of Agreement or Letters of Exchange and progress to this stage once the relationship has proved itself to be ongoing. Be aware, however, that formal agent/distributor agreements should not be seen as legally binding, except perhaps for Australia. It would normally be too expensive for a New Zealand company to sue an offshore partner who breaks such an agreement, despite its legal basis. The key advantage of a formal agreement is that it is a written statement of intent that ensures everyone understands the rules and is working to the same objectives. A checklist of items that should be included in an agent/distributor agreement can be found at the end of this document.

4. Joint Venture

Once you have an established and successful relationship with your representative, you could consider entering into a joint venture with them. This is a public show of your commitment to each other and sends good market signals. For information on joint ventures, see the New Zealand Trade and Enterprise.

Measure the agent or distributor's performance:

While the sales figures and trends will give you a good indication of how well your product and your distributor or agent is performing, it makes good sense to have a more formal performance arrangement in place so you can quickly and easily identify areas for attention.

- Request regular reports on a monthly, quarterly and annual basis. These reports should cover such things as sales, inventory after-sales service, distribution and warehousing, freight, competitor activity, new products, consumer and audience trends.
- Regular visits to the market should be part of a performance review.

- Talk to customers to find out how they think your representative is performing.
- Use your time in the market to ascertain how quickly and accurately your representative is reporting back market trends.

ETHICS IN INTERNATIONAL BUSINESS

Business Ethics:

Business ethics are principles of right or wrong governing the conduct of business people. The text says, "The accepted principles of right and wrong" But there are many differences of opinion among highly ethical business people.

Ethical Issues in International Business

- Many ethical issues and dilemmas are rooted in differences in political systems, law, economic development, and culture. Some key ethical issues in international business
- Employment Practices

When work conditions in a host nation are clearly **inferior** to those in a multinational's home nation, **what standards should be applied**? **How much divergence is acceptable?**

Determinants of Ethical Behavior:

- Organization culture
- Personal ethics
- Decision making processes
- Leadership
- Unrealistic / realistic performance goals

Ethical issues in international business include:

- Child labor
- Workplace diversity
- Working standards
- Human rights
- Equal employment opportunity
- Trust and integrity
- Environmental preservation

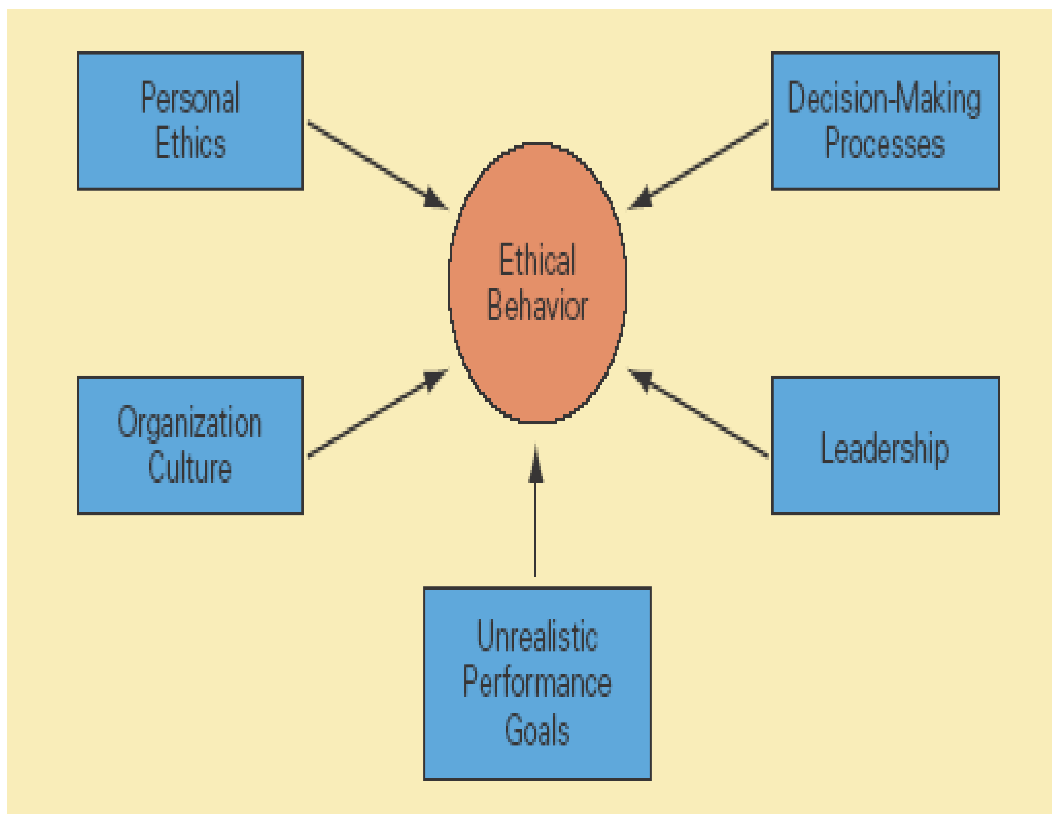
Multinational corporations are constantly confronted with moral dilemmas concerning these ethical issues. At times there is an apparent right course of action that such organizations might choose. Still, the situation in the area of operations might make it difficult to determine what is ethically acceptable.

For example, it is ethical to avoid gender discrimination and give women equal employment opportunities worldwide. But an organization operating in the Middle East may face a dilemma between upholding ethical standards and risking rejection from the local societies. Adhering to the local societies' customs that do not allow equal employment opportunities could risk the organization getting into global scandals. To explain why ethical issues frequently arise in international business, consider a company that operates within the United States, say in California. Most of the company's employees are likely to be from within. The same can be said for the customers and the stakeholders. It can also be said that people working in this hypothetical company exhibit similar or nearly similar societal norms. Most importantly, well-known state and federal laws regulate the company's activities. In such a case, all the players know the labor, wages, and environmental protection laws and have the same integrity perspective. The company is improbable to face ethical issues since all the ethics and regulations are well known. However, suppose the company was to expand its operation to a country in Asia, like Japan. In that case, it will be expected to hire Japanese locals who have different cultural norms from Americans. Besides, Japan has different laws concerning environmental conservation, minimum wages, or an outlook on trust and integrity. The environmental laws and minimum wages in the US are superior to those in Japan. In such a case, the company will be torn between adhering to local laws, which might be less costly to comply with, or adhering to the parent country's law. However,

the former might render the company competitively disadvantaged to other players in the host country.

At the same time, if the company chooses to work under norms established in the parent country, the locals might not feel so good about it as such norms do not align with theirs. This issue becomes even more complicated if the company has more subsidiaries in other regions such as Africa and South America. The bottom line is that every country has different cultural norms and regulations. What might be seen as normal in one country might be unacceptable in another. Besides, unethical practices in international business can be inviting to organizations as they present an advantage over expensive compliance needs.

Ethics in international business, act as a way for multinational corporations to strike a balance between doing what is correct from a global perspective and respecting the customs of local society. Organizations need to identify and counter ethical issues in the world since customers are growing more concerned about how businesses manage their operations rather than only focusing on product quality.



Ethical Decision Making

Five things that an international business and its managers can **do** to make sure ethical issues are considered

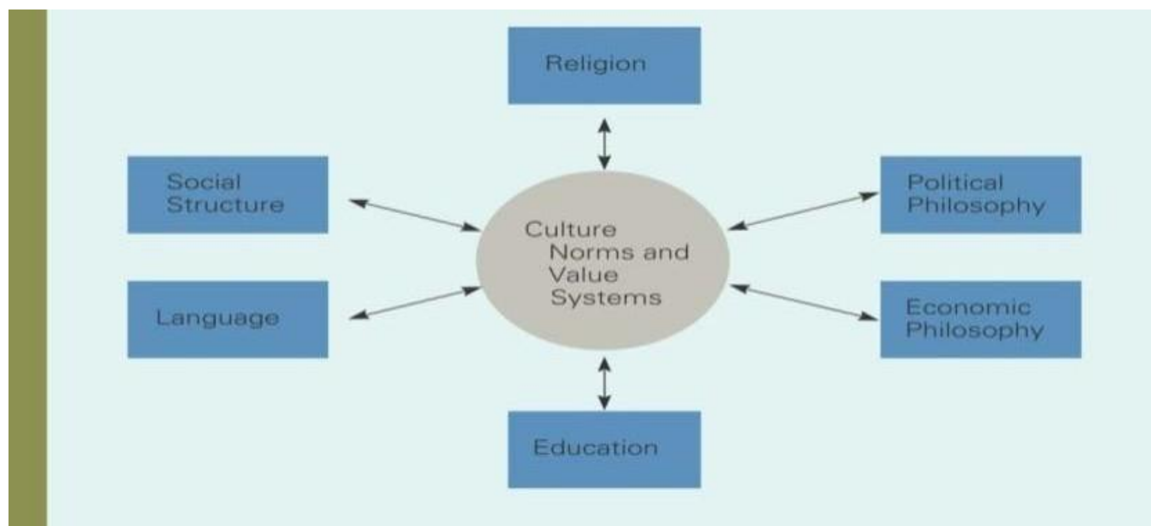
- Favor hiring and promoting people with a well-grounded sense of personal ethics
- Build an organizational culture that places a high value on ethical behavior
- Make sure that leaders within the business not only articulate the rhetoric of
- ethical behavior, but also act in a manner that is consistent with that rhetoric
- Implement decision-making processes that require people to consider the ethical
- dimension of business decisions
- Develop moral

courage **What is culture?**

"A system of values and norms that are shared among a group of people and that when taken together constitute a design for living."

Different components of culture:

 Values: Abstract ideas/assumptions about what a group believes to be good, right and desirable
 Norms: social rules and guidelines that prescribe appropriate behavior in particular situations
 Folkways: Routine conventions of everydaylife.
o Little moral significance
o Generally, social conventions such as dress codes, social manners, and neighborly behavior
 Mores: Norms central to the functioning of society and its social life
o Greater significance than folkways
o Violation can bring serious retribution, Theft, adultery, incest and cannibalism **Determinants of culture**



Improving Global Business Ethics
Seven Moral Guidelines for MNCs

 Inflict no intentional or direct harm
 Produce more good than bad for the host country
 Contribute to host country's development
 Respect the human rights of their employees
 Pay their fair share of taxes
 Respect local cultural beliefs that do not violate moral norms
 Cooperate with the government to develop and enforce background institutions

The Role of Ethics in International Business

International business ethics has a number of open questions and dilemmas. Today it is characterized by the following elements: Every culture and nation has its own values, history, customs and traditions, thus it has developed own ethical values and understanding of ethical principles; There is no international ethical code of conduct, accepted and followed by all the countries; There is a lack of governments' initiative to create ethical cooperation framework and thus to enhance ethical behavior in international business; It is hard to outline those ethical values which would be understandable,

Following approach to international business ethics:

Every individual and every corporate body must outline its ethical values; Every individual and company should ensure understanding of ethical values and belief in their effectiveness and importance;

Employees of every organization must participate in creating a corporate code of conduct, which in this case definitely represents corporate culture, rather than only personal views of a company's leader; Every individual and company must monitor compliance with the outlined values at all times.

All the ethical values must be divided in two categories – rigid and flexible. Rigid are those values which cannot be renounced under any circumstances (honesty, integrity, professionalism), and flexible ones, which are those moral principles which may be interpreted in different ways in different situations (will to understand other cultures' values, remuneration policies).

ETHICAL DECISIONS IN INTERNATIONAL BUSINESS

Positive effect in negotiation

Even before the negotiation process starts, people in a positive mood have more confidence, and higher tendencies to plan to use a cooperative strategy. During the negotiation, negotiators who are in a positive mood tend to enjoy the interaction more, show less contentious behavior, use less aggressive tactics and more cooperative strategies. This in turn increases the likelihood that parties will reach their instrumental goals, and enhance the ability to find integrative gains. Indeed, compared with negotiators with negative or natural affectivity, negotiators with positive affectivity reached more agreements and tended to honor those agreements more. Those favorable outcomes are due to better Decision Making processes, such as flexible thinking, creative Problem Solving, respect for others' perspectives, willingness to take risks and higher confidence. Post negotiation positive affect has beneficial consequences as well. It increases satisfaction with achieved outcome and influences one‘s desire for future interactions. The PA aroused by reaching an agreement facilitates the dyadic relationship, which result in affective commitment that sets the stage for subsequent interactions. PA also has its drawbacks: it distorts perception of self performance, such that performance is judged to be relatively better than it actually is. Thus, studies involving self reports on achieved outcomes might be biased.

Negative effect in negotiation

Negative effect has detrimental effects on various negotiation

Research indicates that negotiator‘s emotions do not necessarily affect the negotiation process. Albarracın et al. (2003) suggested that there are two conditions for emotional effect, both related to the ability (presence of environmental or cognitive disturbances) and the motivation:

1.Identification of the affect: requires high motivation, high ability or both.

2.Determination that the affect is relevant and important for the judgment: requires that either the motivation, the ability or both are low.

According to this model, emotions are expected to affect negotiations only when one is high and the other is low. When both ability and motivation are low the affect will not be identified, and when both are high the affect will be identify but discounted as irrelevant for judgment. A possible implication of this model is, for example, that the positive effects PA has on negotiations (as described above) will be seen only when either motivation or ability are low.

Cultural differences cause four kinds of problems in international business negotiations, at the levels of:

1. Language
2. Nonverbal behaviors
3. Values
4. Thinking and decision-making processes