LECTURE NOTES

ON

INTERNATIONAL BUSINESS

2nd SEMESTER

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Module – I

Exchange of goods and services across the national boundary of a country is called International business

Or

***International business** refers to the trade of goods, services, technology, capital and/or knowledge across national borders and at a **global** or transnational level. It involves cross- border transactions of goods and services between two or more countries.*

Features of International Business

- *Flow of Capital across countries*
- *Accurate and timely information required*
- *Market Expansion*
- *More potential than domestic market*
- *Market segmentation*
- *Large scale operations*
- *Integration of economies*

DOMESTIC VS INTERNATIONAL BUSINESS:

	DOMESTIC	INTERNATIONAL
Meaning	It is carried out within the national or geographical borders Of the country.	It is carried out across the national borders of the country
Environment	Scanning of Domestic Environment	Analysis of international environment. Ex: McDonald's
Tariff	The tariff rate of various countries doesn't have a significant influence on domestic market.	The tariff rate of various countries has direct impact on international trade. Ex: Anti Dumping duty.
Culture	Domestic culture affects the business operations including strategy and design.	Culture of various countries affects the business operations including strategy and design
Foreign Exchange rate	FER and their fluctuations do not affect the domestic business.	It directly affects the business as the conversion rates are affected.

Globalization in Business: Globalization refers to the changes in the world where we are moving away from self-contained 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.

1. Improved transport, making global travel easier. For example, there has been a rapid growth in air-travel, enabling greater movement of people and goods across the globe.
2. Containerization: From 1970, there was a rapid adoption of the steel transport container. This reduced the costs of inter-modal transport, making trade cheaper and more efficient.
3. Improved technology which makes it easier to communicate and share information around the world.
4. Growth of multinational companies with a global presence in many different economies.
5. Growth of global trading blocs which have reduced national barriers. (e.g. European Union, NAFTA, ASEAN)
6. Reduced tariff barriers encourage global trade. Often this has occurred through the support of the WTO.
7. Firms exploiting gains from economies of scale to gain increased specialization. This is an essential feature of new trade theory.
8. Growth of global media.
9. Global trade cycle. Economic growth is global in nature. This means countries are increasingly interconnected. (E.g. recession in one country affects global trade and invariably causes an economic downturn in major trading partners.)
10. Financial system increasingly global in nature. When US banks suffered losses due to the sub-prime mortgage crisis, it affected all major banks in other countries who had bought financial derivatives from US banks and mortgage companies.
11. Improved mobility of capital. In the past few decades, there has been a general reduction in capital barriers, making it easier for capital to flow between different economies. This has increased the ability for firms to receive finance. It has also increased the global interconnectedness of global financial markets.
12. Increased mobility of labour. People are more willing to move between different countries in search for work. Global trade remittances now play a large role in transfers from developed countries to developing countries.

ADVANTAGES:

- Higher Standard of Living
- Free flow of capital
- Optimum utilization of resources
- Advantage due to economy of scale
- Free flow of technology
- Identifying potential untapped market
- Employment Generation.

LIMITATIONS:

- International Business can kill domestic business
- Trade barriers
- Drain of Natural resources
- Technological pirating
- Cultural and social barrier

INTERNATIONAL BUSINESS APPROACHES:

- Ethnocentric Approach: Under this approach, the domestic company does not formulate any different marketing strategy for the foreign market. It views foreign market as an extension to domestic market just like a new region.
- Polycentric Approach: In this approach, the company formulates strategies according to the environment of the foreign country or host country.
- Regiocentric Approach: In this approach, the company views regions as unique and seek to develop an integrated regional strategy.
- Geocentric Approach: Under this approach, the company views the entire world as a potential market and tries to develop integrated world market strategies.

COUNTRY ATTRACTIVENESS

The International business environment includes various factors like social, political, regulatory, cultural, legal and technological factors that surround a business entity in various sovereign nations. There are exogenous factors relative to the home environment of the organization in the international environment. These factors influence the decision-making process on the use of resources and capabilities. They also make a nation either more or less attractive to an international business firm.

We will take up the most important factors and see how they affect the operational process of a business.

Adapting to Changing Needs

Firms do not have any control over the external business environment. Therefore, the success of an international company depends upon its ability to adapt to the overall environment.

Its success also depends on the ability to adjust and manage the company's internal variables to leverage on the opportunities of the external environment. Moreover, the company's capability to control various threats produced by the same environment, also determines its success.

A term called "country attractiveness" is often discussed in the international business fraternity. It is important to consider attractiveness before we move on to discuss environmental factors.

Country Attractiveness

Country attractiveness is a measure of a country's attractiveness to the international investors. In international business, investment in foreign countries is the most important aspect and hence firms want to determine how suitable a country is in terms of its external business environments.

International business firms judge the risks and profitability of doing business in a particular country before investing and starting a business there. This judgment includes studying the environmental factors to arrive at a decision.

It is pretty clear that businesses prefer a country that is less costly, more profitable, and has fewer risks. Cost considerations are related with investment. Profitability is dependent on resources. Risks are associated with the environment and hence it is of prime concern.

Risks may be of various types. However, the general consensus is that a country that is more stable in terms of political, social, legal, and economic conditions is more attractive for starting a business.

Business Environments

There are numerous types of business environments; however the political, the cultural, and the economic environments are the prime ones. These factors influence the decision-making process of an international business firm. It is important to note that the types of environments we discuss here are interlinked; meaning one's state affects the others in varying dimensions.

The Political Factors

The political environment of a nation affects the legal aspects and government rules which a foreign firm has to experience and follow while doing business in that nation. There are definite legal rules and governance terms in every country in the world. A foreign company that operates within a particular country has to abide by the country's laws for the duration it operates there.

Political environment can affect other environmental factors −

- Political decisions regarding economy can affect economic environment.
- Political decisions may affect the socio-cultural environment of a nation.
- Politicians may affect the rate of emergence of new technologies.
- Politicians can exert influence in the acceptance of emerging technologies.

There are four major effects of political environment on business organizations −

- **Impact on Economy** − The political conditions of a nation have a bearing on its economic status. For example, Democratic and Republican policies in the US are different and it influences v arious norms, such as taxes and government spending.

- **Changes in Regulation** − Governments often alter their decisions related to business control. For example, accounting scandals in the beginning of the 21st century prompted the US SEC turn more mindful on the issues of corporate compliance. Sarbanes-Oxley compliance regulations (2002) were social reactions. The social environment demanded the public companies to be more responsible.
- **Political Stability** − Political stability effects business operations of international companies. An aggressive takeover overthrowing the government could lead to a disordered environment, disrupting business operations. For example, Sri Lanka‟s civil war and Egypt and Syria disturbances were overwhelming for businesses operating there.
- **Mitigation of Risk** − There are political risk insurance policies that can mitigate risk. Companies with international operations leverage such insurances to reduce their risk exposure.

The Economic Factors

Economic factors exert a huge impact on international business firms. The economic environment includes the factors that influence a country's attractiveness for international business firms.

- Business firms seek predictable, risk-free, and stable mechanisms. Monetary systems that acknowledge the relative dependence of countries and their economies are good for a firm. If an economy fosters growth, stability, and fairness for prosperity, it has a positive effect on the growth of companies.
- Inflation contributes hugely to a country's attractiveness. High rate of inflation increases the cost of borrowing and makes the revenue contract in domestic currency. It exposes the international firms to foreign-exchange risks.
- Absolute purchasing power parity is also an important consideration. The ratio of exchange rate between two particular countries is identical to the ratio of the price levels. The law of one price states that the real price of a product is same across all nations.
- Relative purchasing power parity (PPP) is valuable for foreign firms. It asks how much money is needed to buy the same goods and services in two particular countries. PPP rates prompt international comparisons of income.

The Cultural Factors

Cultural environments include educational, religious, family, and social systems within the marketing system. Knowledge of foreign culture is important for international firms. Marketers who ignore cultural differences risk failure.

- **Language** − There are nearly 3,000 languages in the world. Language differences are important in designing advertising campaigns and product labels. If a country has several languages, it may be problematic.
- **Colors** − It is important to know how people associate with colors. For example, purple is unacceptable in Hispanic nations because it is associated with death.
- **Customs and Taboos** − It is important for marketers to know the customs and taboos to learn what is acceptable and what is not for the marketing programs.
- **Values** − Values stem from moral or religious beliefs and are acquired through experiences. For example, in India, the Hindus don't consume beef, and fast-food restaurants such as McDonald's and Burger King need to modify the offerings.
- **Aesthetics** − There are differences in aesthetics in different cultures. Americans like suntans, the Japanese do not.
- **Time** − Punctuality and deadlines are routine business practices in the U.S. However, Middle East and Latin American people are far less bound by time constraints.
- **Religious Beliefs** − Religion can affect a product's labeling, designs, and items purchased. It also affects the consumers' values.

Protectionism Vs Liberalization

Protectionism is a policy of protecting the domestic businesses from foreign competition by applying tariffs, import quotas, or many types of other restrictions attached to the imports of foreign competitors' goods and services.

There are many protectionist policies in place in many nations despite the fact that there is a popular consensus that the world economy, as a whole, benefits from free trade.

- **Government-levied tariffs** − The best form of protectionist measure is the government-levied tariffs. The common practice is raising the price of the imported products so that they cost more and hence become less attractive than the domestic products. There are many believers that protectionism is a helpful policy for the emergent industries in the developing nations.
- **Import quotas** − Import quotas are the other forms of protectionism. These quotas limit the amount of products imported into a country. This is considered to be a more effective strategy than protective tariffs. Protective tariffs do not always repel the consumers who are ready to pay higher prices for imported goods.

- **Mercantilism** − Wars and recessions are the major reasons behind protectionism. On the other hand, peace and economic prosperity encourage free trade. In 17th and 18th centuries, the European monarchies used to rely heavily on protectionist policies. This was due to their aim to increase trade and improve the domestic economies. These (currently discredited) policies are called mercantilism.
- **Reciprocal trade agreements** − Reciprocal trade agreements limit the protectionist measures in lieu of eliminating them fully. However, protectionism still exists and is heard when economic hardships or joblessness is aggravated by foreign competition.

Liberalization is the process of relaxation from government control. It is a very important economic term. Technically, it means the reductions in applied restrictions of the government on international trade and capital.

Liberalization and deregulation stimulated the epic run of three major areas of business −

- International trade grew at an average rate of 6% annually between 1948 and 1997.
- FDI was impacted too, which saw the stocks and inflows exceed the rise in world trade.
- Foreign exchange markets achieved an average daily turnover reaching trillions of dollars.

Liberalization and deregulation contributed heavily to the globalization of the world economy.

Ethical Issues International Business

As political, legal, economic, and cultural norms vary from nation to nation, various ethical issues rise with them. A normal practice may be ethical in one country but unethical in another. Multinational managers need to be sensitive to these varying differences and able to choose an ethical action accordingly.

In an international business, the most important ethical issues involve employment practices, human rights, environmental norms, corruption, and the moral obligation of international corporations.

Employment Practices and Ethics

Ethical issues may be related to employment practices in many nations. The conditions in a host country may be much inferior to those in a multinational's home nation. Many may suggest that pay and work conditions need to be similar across nations, but no one actually cares about the quantum of this divergence.12-hour workdays, minimal pay, and indifference in protecting workers from toxic chemicals are common in some developing nations.

Human Rights

Basic human rights are still denied in many nations. Freedom of speech, association, assembly, movement, freedom from political repression, etc. is not universally accepted.

Environmental Pollution

When environmental regulation in the host nation is much inferior to those in the home nation, ethical issues may arise. Many nations have firm regulations regarding the emission of pollutants, the dumping and use of toxic materials, and so on. Developing nations may not be so strict, and according to critics, it results in much increased levels of pollution from the operations of multinationals in host nations.

Corruption

Corruption is an issue in every society in history, and it continues to be so even today. Corrupt government officials are everywhere. International businesses often seem to gain and have gained financial and business advantages by bribing those officials, which is clearly unethical.

Corruption in Japan

In the 1970s, Carl Kotchian, an American business executive who served as the president of **Lockheed Corporation**, paid $12.5 million to Japanese agents and government officials to sell Lockheed's TriStar jet to **All Nippon Airways**. After the case was discovered, U.S. officials charged Lockheed with falsification of its records and tax violations.

The revelations created a scandal in Japan as well. The ministers who took the bribe were charged, and one committed suicide. It even led to the jailing of Japan's prime minister. The Japanese government fell in disgrace, and the Japanese citizens were outraged. Kotchian had, without doubt, engaged in unethical behavior.

Moral Obligations

Some of the modern philosophers argue that the power of MNCs brings with it the social responsibility to give resources back to the societies. The idea of Social Responsibility arises due to the philosophy that business people should consider the social consequences of their actions.

They should also care that decisions should have both meaningful and ethical economic and social consequences. Social responsibility can be supported because it is the correct and appropriate way for a business to behave. Businesses, particularly the large and very successful ones, need to recognize their social and moral obligations and give resources and donations back to the societies.

General Agreement on Tariffs and Trade (GATT)

The **General Agreement on Tariffs and Trade** (**GATT**) is a legal agreement between many countries, whose overall purpose was to promote international trade by reducing or eliminating trade barriers such as tariffs or quotas. According to its preamble, its purpose was the "substantial reduction of tariffs and other trade barriers and the elimination of preferences, on a reciprocal and mutually advantageous basis."

General Agreement on Tariffs and Trade (GATT) includes some multilateral trade agreements formed to abolish the quotas and reduce various tariffs among the participating nations. GATT was formed by 23 countries signing the agreement at Geneva, in 1947. It was aimed to offer an interim arrangement which could be replaced by a United Nations agency soon.

GATT played a hero's role in expanding the world trade in the latter half of the 20th century. 125 nations had already become signatories to GATT when it was replaced by the WTO in 1995

GATT – Major Principles

GATT‟s major principle was trade without discrimination. The participating nations opened the markets impartially to every other member. According to GATT, once a nation and its largest trade allies had agreed to reduce a tariff, that reduction automatically became applicable to all other GATT members.

- GATT preferred protection through tariffs and by leveraging on it, GATT systematically tried to eliminate the import quotas or other quantitative trade restrictions.
- GATT also had homogenous customs regulations and the obligation of the participating nations in negotiating for tariff reductions on any other nation's request.
- The escape clause was also in place for contracting nations to modify the agreements when their domestic producers suffered excessive losses due to the trade concessions.

Role of GATT in Promoting International Trade

GATT‟s role was instrumental in the following aspects −

- GATT formulated standards to direct the contracting nations to take part in international trade. As mentioned above, GATT stipulated some basic principles for the contracting parties.
- GATT cut tariffs for the mutual benefit of accelerated trade liberalization. There was a palpable reduction, about 35% on average, in both Kennedy and Tokyo Rounds.
- GATT brought discrimination in tariff down to promote reducing other trade barriers. GATT had regulated that the participating nations cannot increase tariffs at will.
- GATT, in its progressive days, tried to protect the desires of the developing countries in terms of international trade. It established some special measures, including the tariff protection for select industries. GATT made sure that the developing countries got a preferential treatment.

Finally, GATT was the "court of international trade." Settling the disputes between two or more parties was one of its primary objectives. GATT had become a legal guardian of nations for settling trade disputes.

World Trade Organisation (WTO):

The World Trade Organization (WTO) is the single global international organization dealing with the rules related to international trade. WTO‟s agreements are negotiated and signed by a majority of prominent trading nations. The agreements are ratified in the parliaments of the contracting countries.

Reasons behind the Formation of WTO

On 1st January, 1995, the World Trade Organization replaced GATT. The reasons for GATT being replaced by the WTO are the following.

- GATT was only a provisional arrangement. It lacked the qualities of an international covenant, and it could not ensure the enforcement mechanisms. GATT could do nothing in case of a bilateral trade-agreement failure. There were rules set for enforcement by GATT, but there was no mechanism for its application.

- GATT‟s jurisdiction was applicable only to product-transactions. Due to globalization, services and technologies became a major part of international investments and trade.

- Limitations and restriction on dispute settlement systems of GATT also made it vulnerable to challenges. GATT required a fully positive consensus in the GATT Council to propose the dispute to the panel. Many countries often objected in dispute settlement cases related to discrimination.

- Moreover, GATT‟s rules were not sufficiently strict and their execution was very hard to practice. Many participating parties tried to bend the rules of GATT in their self-interests, and GATT could not verify and inspect these issues.

- Finally, there were some influences of powerful nations in some historical multilateral rounds. Starting from the Geneva Round till the Uruguay Round, national sovereignty was present in the multilateral negotiation rounds.

The WTO was a natural demand of the times for a holistic development of economies.

Role of WTO in Promoting International Trade

WTO promotes business liberalization and economic globalization. It has implemented a substantial decline in tariff levels.

WTO members experienced an average of 40% decline in tariff rate. Agriculture industry and textile trade expansions, security enhancement, anti-dumping and countervailing, dispute-free investment and trade in services and intellectual properties have been the most significant achievements of the WTO.

In 1999, tariff rate in developed countries dropped from 6.3% to 3.9%. Imported duty-free manufactured goods increased from 20% to 43%, and tariffs on imported manufactured goods reduced to 5% on average.

WTO plays a major role in promoting peace among the countries. WTO lets international trade and investment to run smoothly. Countries also get a constructive and fair institution for dealing with disputes over trade issues due to the presence of the WTO.

The WTO also plays a role in decreasing the cost of living. Protectionism increases the cost of the goods. WTO lowers the trade barriers via negotiation and through its non-discrimination policy.

Multilateral trade negotiations and agreements VIII and IX, round discussions and agreements

The Uruguay Round was the 8th round of multilateral trade negotiations (MTN) conducted within the framework of the General Agreement on Tariffs and Trade (GATT), spanning from 1986 to 1993 and embracing 123 countries as "contracting parties". The Round led to the creation of the World Trade Organization, with GATT remaining as an integral part of the WTO agreements. The broad mandate of the Round had been to extend GATT trade rules to areas previously exempted as too difficult to liberalize (agriculture, textiles) and increasingly important new areas previously not included (trade in services, intellectual property, investment policy trade distortions). The Round came into effect in 1995 with deadlines ending in 2000 (2004 in the case of developing country contracting parties) under the administrative direction of the newly created World Trade Organization (WTO).

The main objectives of the Uruguay Round were:

- to reduce agricultural subsidies
- to lift restrictions on foreign investment
- to begin the process of opening trade in services like banking and insurance.
- to include the protection of intellectual property

They also wanted to draft a code to deal with copyright violation and other forms of intellectual property rights.

The **Doha Development Round** or **Doha Development Agenda** (**DDA**) is the trade-negotiation round of the World Trade Organization (WTO) which commenced in November 2001 under then director-general Mike Moore. Its objective was to lower the trade barriers around the world, and thus facilitate increased global trade.

The Doha Round began with a ministerial-level meeting in Doha, Qatar in 2001. The aim was to put less developed countries' priorities at heart. The needs of the developing countries were the core reasons for the meeting. The major factors discussed include trade facilitation, services, rules of origin and dispute settlement. Special and differential treatment for the developing countries was also discussed as a major concern. Subsequent ministerial meetings took place in Cancun, Mexico (2003), and Hong Kong (2005). Related negotiations took place in Paris, France (2005), Potsdam, Germany (2007), and Geneva, Switzerland (2004, 2006, 2008);

Progress in negotiations stalled after the breakdown of the negotiations. The most significant differences are between developed nations led by the European Union (EU), the United States (US), Canada, and Japan and the major developing countries led and represented mainly by India, Brazil, China, and South Africa. There is also considerable contention against and between the EU and the US over their maintenance of agricultural subsidies—seen to operate effectively as trade barriers.

Role of Developing Countries

Developing countries usually don't have the muscle to negotiate in the international markets and they need to follow the developed countries" terms. WTO"s Most favored Nation (MFN) principle, which allows market liberalization, helps the developing nation to trade and prosper. Besides, it also supports the multilateral framework for rules and agreement.

Developing countries benefit from the intellectual property rules of WTO. Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement offers a suitable policy framework that helps to promote technology transfer and FDI flow to developing nations.

There are some preferential treatments available for the developing countries too. Generalized System of Preferences (GSP) enables non-reciprocal preferential treatment by developed countries.WTO offers flexibility to developing countries to implement their TRIPS obligation, especially those that are adopted in the Uruguay round. It helps in holistic improvement of developing nations.

What is the MFN Status?

The MFN status is given under WTO"s General Agreement on Tariffs and Trade (GATT). It is given to an international trade partner to ensure non-discriminatory trade amongst all the members of WTO.

As per the first clause in the General Agreement on Tariffs and Trade (GATT), a country providing MFN status to another country has to provide concessions, privileges, and immunity in trade agreements.

WTO states that if a special status is granted to one trade partner, the country is required to extend it to all members of the WTO without discrimination or any special treatment

An MFN status helps reduce trade barriers and results in a reduction in tariffs especially in customs duty. This in turn strengthens trade-ties between the two countries.

One day after the Pulwama terror attack on 14th February, 2019, India has taken a stern step of withdrawing the Most Favoured Nation or MFN Status of Pakistan. This move would enable India to increase customs duty on goods coming from Pakistan. The decision was taken in the meeting of the Cabinet Committee on Security (CCS) that took place on 15th February 2019.

CHALLENGES TO GLOBAL TRADE

There are seven major challenges to global trade and investment the world is facing now.

Economic Warfare

Globalization has a tough challenge against polarization and conflicting issues. The world is experiencing increased conflicts, major economic powers are seizing influence, financial sanctions are being used as a weapon, and the Internet is breaking into pieces. Therefore, the international flow of money, information, products and services may slow down.

Geo-politicization

Globalization is a kind of Americanization. The United States is still a dominating economy and the hallmark of the international financial system. Moreover, information age is promoting the democratization of information. It is paving the way for demanding more information and the autocrats now need to care more about public opinion. The developments of developing countries are making them more or less like America.

State Capitalism

The United States was a strong nation in the last quarter of the century. But now, state capitalism in a modern form is gripping many nations. This is creating new segments in the markets and destroying the uniformity expected from globalization. Now, there is nothing predominantly American or about globalization itself.

Lack of Leadership

Globalization will continue rapidly, but the U.S led world order is getting diminished. An inconsistent, war-ridden United States lacks the will and ability to provide global leadership. Moreover, no other country is interested in taking its place. The West is having its own problems, and allies are only interested in hedging their bets. Therefore, there is no clear and definite way for globalization to progress and it is getting distorted.

Power Distribution

China, Russia, Turkey, India, and some other emerging nations are getting powerful enough to dismantle the US led theory of globalization. But they lack synchronization and influence. Their values and interests are not compatible. So, a regionalized world is emerging. Americanization and globalization are neither believed to be one and the same now nor is it preached by these power-seeking nations.

Weaker Underdogs

The regional economic powerhouses are getting more room to operate in today’s world. Russia is intruding in its backyard, Germany is experiencing firm control over Euro zone, and China is rapidly rising in the Asia-Pacific. These major countries are trying to consolidate power without caring for the smaller countries near them. It is a kind of ‘hollowing of the peripherals’ that is accelerating.

Price Fluctuations of Natural Resources

The oil monopoly is deteriorating and many clashes and terrorist incidents are tearing the world apart. In such turmoil, the very essence of globalization is somehow getting blurred. These time-sensitive challenges are being faced by all international and huge global companies. While the problems don’t seem to end soon, the global companies now have the choice to exercise their power in a global scale. They may or may not adapt to the new trend, but their superiority and powers have definitely got a boost due to the predominantly geopolitical crises.

International Business Module -II

Global Trade - Major Challenges

Global trade and investment or broadly, globalization, is a common market condition for all countries of the world now. However, it is not free from challenges. To be specific, there are seven major challenges to global trade and investment the world is facing now.

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Foreign direct investment (**FDI**) is an investment made by a company or individual in one country in business interests in another country, in the form of either establishing business operations or acquiring business assets in the other country, such as ownership or controlling interest in a foreign company.

FDI and its Types

Strategically, FDI comes in three types −

- **Horizontal** − In case of horizontal FDI, the company does all the same activities abroad as at home. For example, Toyota assembles motor cars in Japan and the UK.
- **Vertical** − In vertical assignments, different types of activities are carried out abroad. In case of **forward vertical FDI,** the FDI brings the company nearer to a market (for example, Toyota buying a car distributorship in America). In case of **backward Vertical FDI**, the international integration goes back towards raw materials (for example, Toyota getting majority stake in a tyre manufacturer or a rubber plantation).
- **Conglomerate** − In this type of investment, the investment is made to acquire an unrelated business abroad. It is the most surprising form of FDI, as it requires overcoming two barriers simultaneously – one, entering a foreign country and two, working in a new industry

Vehicles of FDI

- **Reciprocal distribution agreements** − This type of strategic alliance is found more in trade-based verticals, but in practical sense, it does represent a type of direct investment. Basically, two companies, usually within the same or affiliated industries, but from different nations, agree to become national distributors for each other's products.
- **Joint venture and other hybrid strategic alliances** − Traditional joint venture is bilateral, involving two parties who are within the same industry, partnering for getting some strategic advantage. Joint ventures and strategic alliances offer access to proprietary technology, gaining access to intellectual capital as human resources, and access to closed channels of distribution in select locations.
- **Portfolio investment** − For most of the 20th century, a company's portfolio investments were not considered a direct investment. However, two or three companies with "soft" investments in a company could try to find some mutual interests and use their shareholding for management control. This is another form of strategic alliance, sometimes called **shadow alliances**.

Foreign Institutional Investors (FII)

Foreign Institutional Investors (FII) is an investment fund or a gathering of investors. Such a fund is registered in a foreign country, i.e. not in the country it is investing in. Such institutional investors mostly involve hedge funds, mutual

funds, pension funds, insurance bonds, high-value debentures, investment banks etc.

We use this term FII for foreign players investing funds in the financial market of India. They play a big role in the development of our economy. The amount of funds they invest is very considerable.

So when such FII's buy shares and securities the market is bullish and trends upwards. The opposite may also happen when they withdraw their funds from the markets. So they have considerable sway over the market.

CLASSICAL THEORIES OF INTERNATIONAL TRADE:

Adam Smith and David Ricardo gave the classical theories of international trade.

According to the theories given by them, when a country enters in foreign trade, it benefits from specialization and efficient resource allocation.

The foreign trade also helps in bringing new technologies and skills that lead to higher productivity.

The assumptions taken under this theory' are as follows:

a. There are two countries producing two goods.

b. The size of economies of these countries is equal

c. There is perfect mobility of factors of production within countries

d. Transportation cost is ignored

e. Before specialization, country's resources are equally divided to produce each good

The classical theories are divided into three theories, as shown in Figure-3:

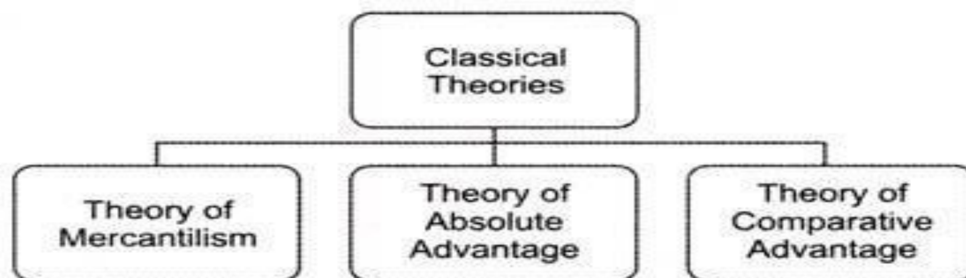


Figure-3: Classical Trade Theories

Theory of Mercantilism:

Mercantilism is the term that was popularized by Adam Smith, Father of Economics, in his book, The Wealth of Nations. Western European economic policies were greatly dominated by this theory. The theory of mercantilism holds that countries should encourage export and discourage import.

It states that a country's wealth depends on the balance of export minus import. According to this theory, government should play an important role in the economy for encouraging export and discouraging import by using subsidies and taxes, respectively. In those days, gold was used for trading goods between countries.

Thus, export was treated as good as it helped in earning gold, whereas, import was treated as bad as it led to the outflow of gold. If a nation has abundant gold, then it is considered to be a wealthy nation. If all the countries follow this policy, there may be conflicts, as no one would promote import. The theory of mercantilism believed in selfish trade that is a one- way transaction and ignored enhancing the world trade. Mercantilism was called as a zero-sum game as only one country benefitted from it.

Theory of Absolute Advantage:

Given by Adam Smith in 1776, the theory of absolute advantage stated that a country should specialize in those products, which it can produce efficiently. This theory assumes that there is only one factor of production that is labor.

Adam Smith stated that under mercantilism, it was impossible for nations to become rich simultaneously. He also stated that wealth of the countries does not depend upon the gold reserves, but upon the goods and services available to their citizens.

Adam Smith wrote in The Wealth of Nations, "If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage".

He stated that trade would be beneficial for both the countries if country A exports the goods, which it can produce with lower cost than country B and import the goods, which country B can produce with lower cost than it.

An example can be used to prove this theory. Suppose there are two countries A and B, which produce tea and coffee with equal amount of resources that is 200 laborers. Country A uses 10 laborers to produce 1 ton of tea and 20 laborers to produce 1 ton of coffee. Country B uses 25 units of laborers to produce tea and 5 units of laborers to produce 1 ton of coffee.

This is shown in Table- 1:

Table-1: Resources used to produce a ton of Tea and Coffee without Trading

	Country A	Country B
Tea	10	25
Coffee	20	5

It can be seen from Table-2 that country A has absolute advantage in producing tea as it can produce 1 ton of tea by using less laborers as compared to country B. On the other hand, country B has absolute advantage in producing coffee as it can produce 1 ton of coffee by employing less laborers in comparison to country A.

Now, if there is no trade between these countries and resources (in this case there are total 200 laborers) are being used equally to produce tea and coffee, country A would produce 10 tons of tea and 5 tons of coffee and country B would produce 4 tons of tea and 20 tons of coffee. Thus, total production without trade is 39 tons (14 tons of tea and 25 tons of coffee).

Table-2 shows the production without the trade between country A and country B:

Table-2: Production without Trade

	Country A (in tons)	Country B (in tons)
Tea	10	4
Coffee	5	20

If both the countries trade with each other and specialize in goods in which they have absolute advantage, the total production would be higher. Country A would produce 20 tons of tea with 200 units of laborers; whereas, country B would produce 40 tons of coffee with 200 units of laborers. Thus, total production would be 60 units (20 tons of tea and 40 tons of coffee).

The production of tea and coffee after trade is shown in Table-3:

Table-3: Production with Trade

	Country A (in tons)	Country B (in tons)
Tea	20	0
Coffee	0	40

Without specialization, total production of countries was 39 tons, which becomes 60 tons after specialization. Therefore, the theory of absolute advantages shows that trade would be beneficial for both the countries.

Theory of Comparative Advantage:

Many questions may come in mind after reading the absolute advantage theory that what would happen if a country has absolute advantage in all the products or no absolute advantage in any of the product. How such a country would benefit from trade? The answers of these questions was given by David Ricardo in his theory of comparative advantage, which states that trade can be beneficial for two countries if one country has absolute advantage in all the products and the other country has no absolute advantage in any of the products.

According to Ricardo, "…a nation, like a person, gains from the trade by exporting the goods or services in which it has its greatest comparative advantage in productivity and importing those in which it has the least comparative advantage. "

This theory assumes that labor as the only factor of production in two countries, zero transport cost, and no trade barriers within the countries. Let us understand this theory with the help of an example.

Suppose there are two countries A and B, producing two commodities wheat and wine with labor as the only factor of production. Now assume that both the countries have 200 laborers and they use 100 laborers to produce wheat and 100 laborers to produce wine.

Table-4 shows the production of wheat and wine in Country X and Country Y before trade:

Table-4: Situation of Country X and Country Y before Trade

	Country X	Country Y
Wheat	20	15
Wine	40	10

Table-4 depicts that country X can produce 20 units; whereas, country Y can produce 15 units of wheat by using 100 laborers. In addition, country X can produce 40 units; whereas, country‟ Y can produce 10 units of wine by employing 100 laborers.

Thus, country X has absolute advantage in producing both the products. As already discussed, country X employs same number of laborers (100 laborers in production of each good) in producing both wine and wheat; however, the production of wine is more than the production of wheat.

It shows that country‟ X has comparative advantage in producing wine. Similarly, country Y also employs same number of laborers (100 laborers in production of each good) in manufacturing wheat and wine; however, its production of wheat is more than the wine. It indicates that country Y has comparative advantage in manufacturing wheat.

For example, country X has decided to produce 60 units of wine by employing 150 laborers. It uses 50 laborers to produce 10 units of wheat. On the other hand, country Y has decided to use all the 200 laborers to produce 30 units of wheat. It would not produce any unit of wine.

This data is represented in Table-5:

Table-5: Production of Country X and Country Y after Specialization		
	Country X	Country Y
Wheat	10	30
Wine	60	0

Now, country X exchanges 14 units of wine with 14 units of wheat produced by country Y.

The situation of both the countries after trade is shown in Table-6:

Table-6: Situation of Country X and Country Y after Trade		
	Country X	Country Y
Wheat	24	16
Wine	46	14

It can be observed from Table-6 that both the countries have gained from trade. Before trade, country X has 20 units of wheat and 40 units of wine; however, after trade, country Y has 24 units of wheat and 46 units of wine.

On the other hand, country Y has 15 units of wheat and 10 units of wine before trade; however, it has 16 units of wheat and 14 units of wine after trade. Therefore, comparative advantage explains that trade can create benefit for both the countries even if one country has absolute advantage in the production of both the goods.

Modern Theories

The Heckscher and OhlinModel

The Heckscher–Ohlin theory deals with two countries‟ trade goods and services with each other, in reference with their difference of resources. This model tells us that the comparative advantage is actually influenced by relative abundance of production factors. That is, the comparative advantage is dependent on the interaction between the resources the countries have.

Moreover, this model also shows that comparative advantage also depends on production technology (that influences relative intensity). Production technology is the process by which various production factors are being utilized during the production cycle.

The Heckscher–Ohlin theory tells that trade offers the opportunity to each country to specialize. A country will export the product which is most suitable to produce in exchange for other products that are less suitable to produce. Trade benefits both the countries involved in the exchange.

The differences and fluctuations in relative prices of products have a strong effect on the relative income gained from the different resources. International trade also affects the distribution of incomes.

Global Competitiveness

The International Institute for Management Development defines competitiveness as "a field of economic knowledge which analyzes the facts and policies that shaped the ability of a nation to create and maintain an environment that sustains more value creation for its enterprises and more prosperity for its people."

The World Economic Forum defines global competitiveness as "the ability of a country to achieve sustained high rates of growth in gross domestic product (GDP) per capita."

Factors Affecting Global Competitiveness

Business firms abide by the rules and regulations formed by the government. The government assumes a very important role in enhancing competitiveness. Governments must promote trade by re engineering

the system and procedure. Governments should be more responsive, reducing bureaucratic red tape.

Physical infrastructure plays a critical role in improving the global competitiveness of a country. This will lead to the smoother movement of people, products, and services, facilitating faster delivery of goods and services.

The business environment should be as such that it improves **coordination among public-sector agencies**. The best methods include providing support and incentives for R&D activities, HRD and education, encouraging innovativeness and creativity, facilitating the improvement of industrial blocks, and productivity enhancements of SMEs.

High total factor productivity (TFP) is a boon for economic growth. It shows the synergy and efficiency of both capital and HR utilization and promotes national competitiveness.

Productivity campaigns are important because they promote public-awareness and provide mechanisms to use the productivity tools and techniques.

Intensifying R&D activities that contribute to creativity, innovation, and indigenous technological development is also an important factor.

Improving the capacities of SMEs to become increasingly productive suppliers and exporters makes strategic sense.

Regional Trading Blocs

A regional trading bloc (RTB) is a co-operative union or group of countries within a specific geographical boundary. RTB protects its member nations within that region from imports from the non-members. Trading blocs are a special type of economic integration.

There are **four** types of trading blocs −

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

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

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

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

Regional Trading Blocs – Advantages

The advantages of having a Regional Trading Bloc are as follows −

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

- **Economies of Scale** − The larger markets created results in lower costs due to mass manufacturing of products locally. These markets form economies of scale.
- **Competition** − Trade blocs bring manufacturers from various economies, resulting in greater competition. The competition promotes efficiency within firms.
- **Trade Effects** − As tariffs are removed, the cost of imports goes down. Demand changes and consumers become the king.
- **Market Efficiency** − The increased consumption, the changes in demand, and a greater amount of products result in an efficient market.

Regional Trading Blocs – Disadvantages

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

- **Regionalism** − Trading blocs have bias in favor of their member countries. These economies establish tariffs and quotas that protect intra-regional trade from outside forces. Rather than following the World Trade Organization, regional trade bloc countries participate in regionalism.
- **Loss of Sovereignty** − A trading bloc, particularly when it becomes a political union, leads to partial loss of sovereignty of the member nations.
- **Concessions** − The RTB countries want to let non-member firms gain domestic market access only after levying taxes. Countries that join a trading bloc need to make some concessions.
- **Interdependence** − The countries of a bloc become interdependent on each other. A natural disaster, conflict, or revolution in one country may have adverse effect on the economies of all participants.

Major Trade Blocs

ASSOCIATION OF SOUTHEAST ASIAN NATIONS (ASEAN)

Association of Southeast Asian Nations (ASEAN) was established on August 8, 1967, in Bangkok (Thailand).

Members − The member states are Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam.

Goals − The goals of ASEAN are to (a) accelerate economic growth, social progress, and cultural development in the region and (b) promote regional peace and stability and adhere to United Nations Charter.

ASEAN Economic Community (AEC) − The AEC is aiming to transform ASEAN into a

single entity and a production powerhouse that is highly competitive and fully compatible with the global economy.

EUROPEAN UNION (EU)

The European Union (EU) was founded in 1951 by six neighboring states as the European Coal and Steel Community (ECSC). Over time, it became the European Economic Community (EEC), then the European Community (EC), and was ultimately transformed into the European Union (EU). EU is the single regional bloc with the largest number of member states (28).

Members − Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, The Netherlands, and the United Kingdom.

Goal of EU − To construct a regional free-trade association of states through the union of political, economic, and executive connections.

MERCADO COMUN DEL CONO SUR (MERCOSUR)

Mercado Comun del Cono Sur (MERCOSUR) was established on 26 March 1991 with the Treaty of Assunción. The major languages spoken in this region are Spanish and Portuguese.

Members − Argentina, Brazil, Paraguay, Uruguay, and Venezuela.
Bolivia is undergoing the process of becoming a full member. Associate members include Chile, Colombia, Ecuador, Guyana, Peru, and Suriname.

Associate members are allowed to do preferential trade but not allowed to have tariff benefits like the registered members. Mexico has an observer status.

Goals − Accelerate sustained economic development based on social justice, environmental protection, and reduction of poverty.

NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA)

The North American Free Trade Agreement (NAFTA) was signed on 1 January 1994.

Members − Canada, Mexico, and United States of America.

Goals − The goals of NAFTA are to (a) eliminate trade barriers among its member states, (b) promote an environment for free trade, (c) increase investment opportunities, and (d) protect intellectual property rights.

Strategic Compulsions

To survive in the world of cut-throat competition, companies must sell their products in the global market. It is necessary to come up with new strategies to win more customers. Effective strategic management requires strategic estimation, planning, application and review/control.

The path for strategic management is activated by compulsions like modern developments in the societal and economic theory and the recent changes in the form of business, apart from the economic context.

Areas of StrategicCompulsions

A list of compulsions that a global business might have to face is the following:

E-commerce and Internet Culture − Expansion of internet and information technology made the business move towards e-commerce. Online shopping /Selling and Advertising are important issues. These factors compel the businesses to go modern.

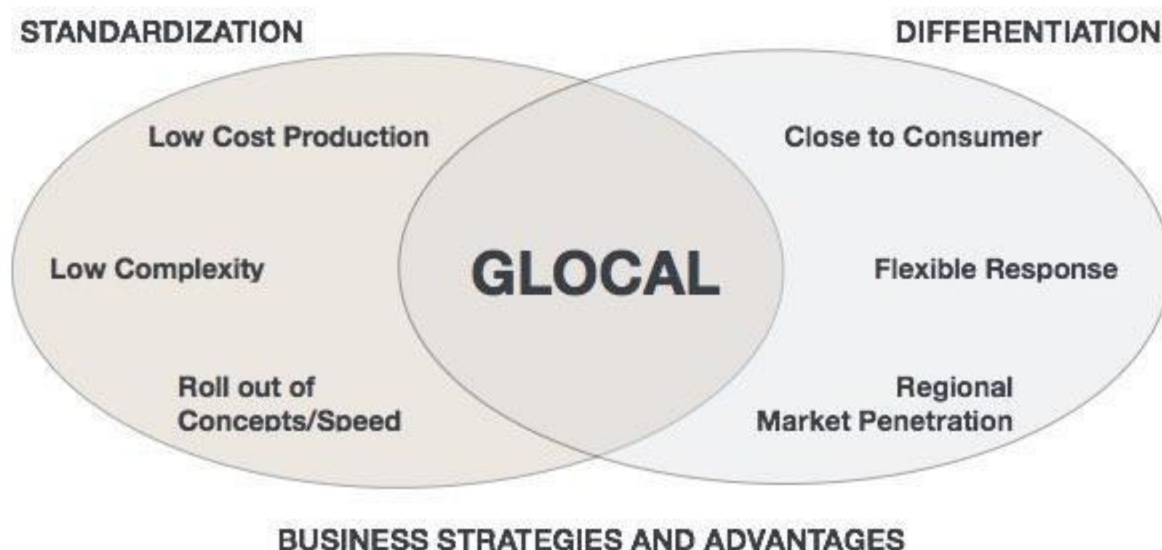
Hyperactive Competition − Businesses now are hyper-competitive which compel them to draw a competitive strategy that includes general competitive intelligence to win the market share.

Diversification − Uncertainty and operational risks have increased in the current global markets. Companies now need to protect themselves by diversifying their products and operations. Businesses now are compelled to focus on more than one business, or get specialized in one business.

Active Pressure Groups − Contemporary pressure groups direct businesses to be more ethical in their operations. Most of the multinationals are now spending a good deal to address their Corporate Social Responsibility (CSR).

Standardization Vs Differentiation

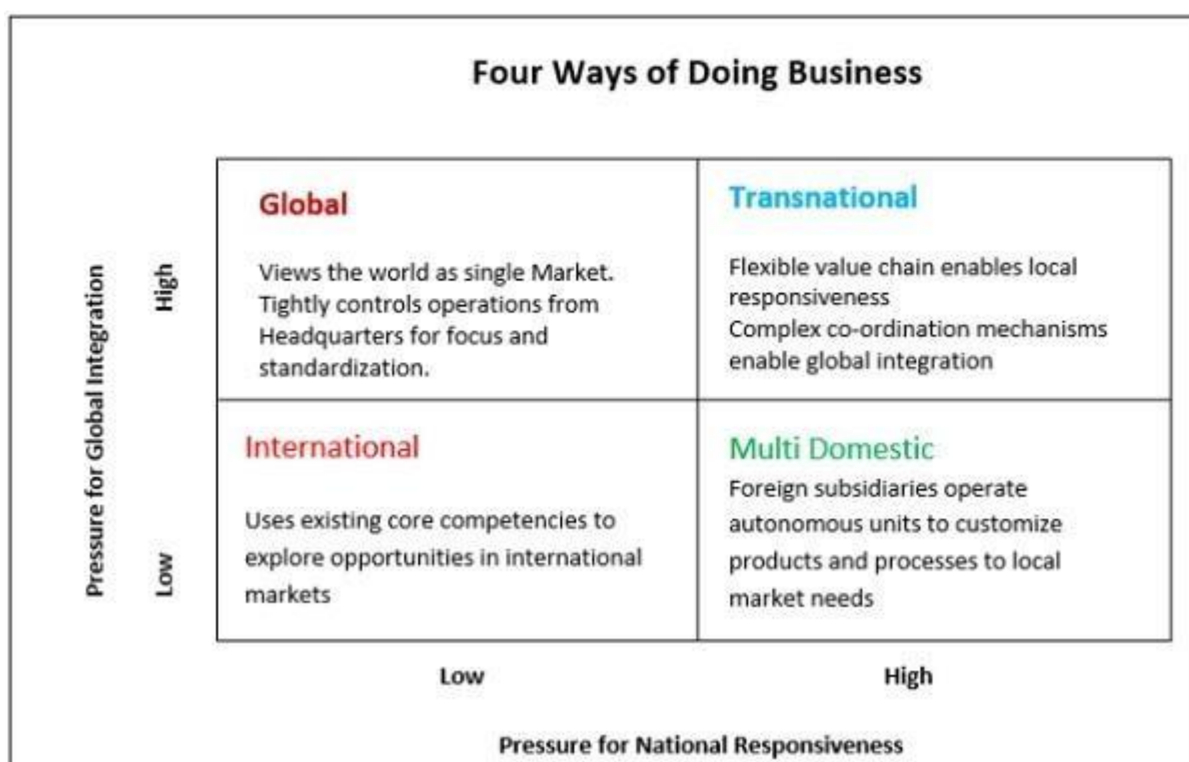
Standardization and differentiation are the two sides of globalization. By standardization, we mean to show the global representation, while differentiation looks upon local competitiveness. The following figure depicts how standardization differs from differentiation.



Strategic Options

Strategic Options include a set of strategies that helps a company in achieving its organizational goals. It is important to do a SWOT analysis of the internal environment and also the external environment to get the list of possible strategic alternatives.

A business can't run on gut feeling and hence, strategic options are indispensable tools for every international business manager. The following diagram shows the very basic options to choose – whether to go global or act local while improving the business in a holistic manner.



Factors that Affect Strategic Options

There are many factors that need to be taken care of while choosing the best possible strategic options. The most influential ones are the following −

External Constraints − The survival and prosperity of a business firm is fully dependent on interaction and communication with the elements that are intrinsic to the business. It includes the owners, customers, suppliers, competitors, government, and the stakeholders of the community.

Intra-organizational Forces − The big decisions of a company are often influenced by the power-play among various interest groups. The strategic decision-making processes are no exception. It depends on the strategic choices made by the lower Management and top notch strategic management people.

Values and Preferences towards Risk − Values play a very important role, It has been observed hat the successful managers have a more pragmatic, interactive and dynamic progressive and achievement seeking values. The risk takers in the high- growth less-stable markets prefer to be the pioneers or innovators. They seek an early entry into new, untapped markets.

Impact of Past Strategies − A strategy made earlier may affect the current strategy too. Past strategies are the starting point of building up of a new strategy.

Time Constraints − There may be deadlines to be met. There may be a period of commitment, which would require a company to take immediate action.

Information Constraints − The choice of a strategy depends heavily on the availability of information. A company can deal with uncertainty and risks depending on the availability of information at its disposal. The less is the amount of information, the greater is the probability of risks.

Competitor’s Risk − It is important to weigh the strategic choices the competitors may have. A competitor who adopts a counter-strategy must be taken into account by the management. The likelihood of a competitor's strength to react and its probable impact will influence the strategic choices.

Global Portfolio Management

Global Portfolio Management, also known as **International Portfolio Management** or **Foreign Portfolio Management,** refers to grouping of investment assets from international or foreign markets rather than from the domestic ones. The asset grouping in GPM mainly focuses on securities. The most common examples of Global Portfolio Management are −

- Share purchase of a foreign company
- Buying bonds that are issued by a foreign government
- Acquiring assets in a foreign firm

Factors Affecting Global PortfolioInvestment

Global Portfolio Management (GPM) requires an acute understanding of the market in which investment is to be made. The major financial factors of the foreign country are the factors affecting GPM. The following are the most important factors that influence GPM decisions.

Tax Rates

Tax rates on dividends and interest earned is a major influencer of GPM. Investors usually choose to invest in a country where the applied taxes on the interest earned or dividend acquired is low. Investors normally calculate the potential after-tax earnings they will secure from an investment made in foreign securities.

Interest Rates

High interest rates are always a big attraction for investors. Money usually flows to countries that have high interest rates. However, the local currencies must not weaken for long-term as well.

Exchange Rates

When investors invest in securities in an international country, their return is mostly affected by −

The apparent change in the value of the security.

The fluctuations in the value of currency, in which the security is managed.

Investors usually shift their investment when the value of currency in a nation they invest weakens more than anticipated.

Modes of GlobalPortfolio Management

Foreign securities or depository receipts can be bought directly from a particular country's stock exchange. Two concepts are important here which can be categorized as **Portfolio Equity** and **Portfolio Bonds**. These are supposed to be the best modes of GPM. A brief explanation is provided hereunder.

Portfolio Equity

Portfolio equity includes net inflows from equity securities other than those recorded as direct investment and including shares, stocks, depository receipts (American or global), and direct purchases of shares in local stock markets by foreign investors.

Portfolio Bonds

Bonds are normally medium to long-term investments. Investment in Portfolio Bond might be appropriate for you if −

You have additional funds to invest.

You seek income, growth potential, or a combination of the two.

You don't mind locking your investment for five years, ideally longer.

You are ready to take some risk with your money.

You are a taxpayer of basic, higher, or additional-rate category.

Global Mutual Funds

Global mutual funds can be a preferred mode if the Investor wants to buy the shares of an internationally diversified mutual fund. In fact, it is helpful if there are open-ended mutual funds available for investment.

Closed-end Country Funds

Closed-end funds invest in internationals securities against the portfolio. This is helpful because the interest rates may be higher, making it more profitable to earn money in that particular country. It is an indirect way of investing in a global economy. However, in such investments, the investor does not have ample scope for reaping the benefits of diversification, because the systematic risks are not reducible to that extent.

Drawbacks of Global PortfolioManagement

Global Portfolio Management has its share of drawbacks too. The most important ones are listed below.

Unfavorable Exchange Rate Movement − Investors are unable to ignore the probability of exchange rate changes in a foreign country. This is beyond the control of the investors. These changes greatly influence the total value of foreign portfolio and the earnings from the investment. The weakening of currency reduces the value of securities as well.

Frictions in International Financial Market − There may be various kinds of market frictions in a foreign economy. These frictions may result from Governmental control, changing tax laws, and explicit or implicit transaction costs. The fact is governments actively seek to administer international financial flows. To do this, they use different forms of control mechanisms such as taxes on international flows of FDI and applied restrictions on the outflow of funds.

Manipulation of Security Prices − Government and powerful brokers can influence the security prices. Governments can heavily influence the prices by modifying their monetary and fiscal policies. Moreover, public sector institutions and banks swallow a big share of securities traded on stock exchanges.

Unequal Access to Information − Wide cross-cultural differences may be a barrier to GPM. It is difficult to disseminate and acquire the information by the international investors beforehand. If information is tough to obtain, it is difficult to act rationally and in a prudent manner.

Modes of Entry

The long-term advantages of doing international business in a particular country depend upon the following factors −

- Size of the market demographically
- The purchasing power of the consumers in that market
- Nature of competition

By considering the above-mentioned factors, firms can rank countries in terms of their attractiveness and profitability. The **timing of entry** into a nation is a very important factor. If a firm enters the market ahead of other firms, it may quickly develop a strong customer base for its products.

There are seven major modes of entering an international market. In this chapter, we will take up each mode and discuss their advantages and disadvantages.

Exporting

An item produced in a domestic market can be sold abroad. Storing and processing is mainly done in the supplying firm's home country. Export can increase the sales volume. When a firm receives canvassed items and exports them, it is called **Passive Export**.

Alternately, if a strategic decision is taken to establish proper processes for organizing the export functions and for obtaining foreign sales, it is known as **Active Export**.

Advantages − Low investment; Less risks

Disadvantages − Unknown market; No control over foreign market; Lack of information about external environment

Licensing

In this mode of entry, the manufacturer of the home country leases the right of intellectual properties, i.e., technology, copyrights, brand name, etc., to a manufacturer of a foreign country for a predetermined fee. The manufacturer that leases is known as the **licensor** and the manufacturer of the country that gets the license id known as the **licensee**.

Advantages − Low investment of licensor; Low financial risk of licensor; Licensor can investigate the foreign market; Licensee's investment in R&D is low; Licensee does not bear the risk of product failure; any international location can be chosen to enjoy the advantages; No obligations of ownership, managerial decisions, investment etc.

Disadvantages − Limited opportunities for both parties involved; Both parties have to manage product quality and promotion; One party's dishonesty can affect the other; Chances of misunderstanding; Chances of trade secrets leakage of the licensor.

Franchising

In this mode, an independent firm called the **franchisee** does the business using the name of another company called the **franchisor**. In franchising, the franchisee has to pay a fee or a fraction of profit to the franchisor. The franchisor provides the trademarks, operating process, product reputation and marketing, HR and operational support to the franchisee.

Note − The Entrepreneur magazine's top ranker in "The 2015 Franchise 500" is Hampton Hotels. It has 2,000 hotels in 16 countries.

Advantages − Low investment; Low risk; Franchisor understands market culture, customs and environment of the host country; Franchisor learns more from the experience of the franchisees; Franchisee gets the R&D and brand name with low cost; Franchisee has no risk of product failure.

Disadvantages − Franchising can be complicated at times; Difficult to control; Reduced market opportunities for both franchisee and franchisor; Responsibilities of managing product quality and product promotion for both; Leakage of trade secrets

Turnkey Project

It is a special mode of carrying out international business. It is a contract under which a firm agrees – for a remuneration – to fully carry out the design, create, and equip the production facility and shift the project over to the purchaser when the facility is operational.

Mergers & Acquisitions

In Mergers & Acquisitions, a home company may merge itself with a foreign company to enter an international business. Alternatively, the home company may buy a foreign company and acquire the foreign company"s ownership and control. M&A offers quick access to international manufacturing facilities and marketing networks.

Advantages − Immediate ownership and control over the acquired firm's assets; Probability of earning more revenues; The host country may benefit by escaping optimum capacity level or overcapacity level

Disadvantages − Complex process and requires experts from both countries; No addition of capacity to the industry; Government restrictions on acquisition of local companies may disrupt business; Transfer of problems of the host country's to the acquired company.

Joint Venture

Joint Venture can be defined as when two or more firms join together to create a new business entity. The uniqueness in a joint venture is its shared ownership. Environmental factors like social, technological, economic and political environments may encourage joint ventures.

Advantages − Joint ventures provide significant funds for major projects; Sharing of risks between or among partners; Provides skills, technology, expertise, marketing to both parties.

Disadvantages − Conflicts may develop; Delay in decision-making of one affects the other party and it may be costly; The venture may collapse due to the entry of competitors and the changes in the partner's strength; Slow decision-making due to the involvement of two or more decision-makers.

Wholly Owned Subsidiary

Wholly Owned Subsidiary is a company whose common stock is fully owned by another company, known as the **parent company**. A wholly owned subsidiary may arise through acquisition or by a spin-off from the parent company.

Instruments of Trade Policy

Trade is carried out between two nations and can often, also be done with many countries. Trade is carried out with the help of different trade practices. Many nations are nominally committed to free trade protecting their home market from foreign competition if possible and securing other markets of their exports.

According to Ohlin, in a world without trade barriers, trade patterns will be determined by the following factors.

(i) Relative productivity of different factors of production in different countries.

(ii) Countries that specialize in the production of products.

(iii) Imports of products in which a country is less efficient.

(iv) Trade patterns will be determined by the profit margin.

(v) Limiting the governments to adopt such policies that restrict imports and encourage exports.

(vi) Access of markets for their exports.

There are six main instruments of trade policy:

(i) Tariffs

(ii) Subsidies

(iii) Import Quotas

(iv) Voluntary Export Restraints

(v) Local Content Requirements

(vi) Administrative Policies

TARIFFS

Tariffs are the oldest and simplest instrument of trade policy. They are the instrument that GATT (General agreement on tariff and trade) has been most successful in limiting. But a fall in tariff barriers in recent decades has been accompanied by a rise in non-tariff barriers such as subsidies, quotas and voluntary export restraints. It is generally levied on imports and it is the oldest form of trade policy.

Tariffs fall into two categories

(i) Specific Tariffs are levied as a fixed charge for each unit of imports.

(ii) Ad Valorem Tariffs are levied as a proportion of the value of the imported goods

Profits of Imposing Tariffs:

i) Beneficial for the government as it raises the revenue.

(ii) Beneficial for the home producers because they get market for their product.

(iii) Beneficial for the growth of domestic country.

(iv) It helps in generating more revenue for the government by increasing the rate of tariff on certain commodities.

(v) Restrict imports

(vi) Encourage exports.

(vii) Domestic production goes up.

(viii) Domestic price goes up.

Since 1947, there have been many changes in the agreement. It is known as (WTO) World Trade Organisation. GATT negotiations have reduced tariffs. Now countries that want to practice protectionism have to use other non-tariff measures.

Such measures are:

(i) Import Quota.

(ii) VERs (Voluntary Export Restrictions).

(iii) Quality Standards.

(iv) Domestic Content Requirements.

Types of Quotas:

Tariff Quota -Under this category, import of a commodity is allowed to enter a country at an especially low rate of duty (or free duty). In case the volume of import goes above the specific volume, the increased import duty is levied.

Unilateral Quota -Only one country specifies a limit on the quantity of commodity to be imported during a stipulated or a specific period.

Bilateral Quota - It is fixed through negotiation between the importing country and ' exporting country.

Mixing Quota - Various countries have regulations regarding utilization of a certain proportion of domestic raw materials in the production of specified finished products. These regulations are sometimes referred as "Linked Usage" regulations. They serve to limit imports to a more or less ratio.

Import Licensing - By this method, an even distribution of quotas between different suppliers is ensured without disrupting the market.

Effects of a Quota:

(i) Reduces the quantity of imports.

(ii) Helps maintain a fair price for the commodity.

(ii) It drives the domestic price above the world price.

Subsidies

Subsidy is a form of government payment to a domestic producer. Subsidies take many forms including cash grants, low interest loans, tax breaks and government equity participation in domestic firms. By lowering costs, subsidies help domestic producers in two ways. They help them to compete against low cost foreign imports and they help them gain export markets.

The main beneficiaries are domestic producers whose international competitiveness is increased as a result of subsidies. Subsidies are a great help to domestic producers. Subsidies can help a firm achieve a first mover advantage in an emerging industry. If this is achieved, further gains to the domestic economy arise from the employment and tax revenues.

Arguments in favor of Subsidy:

Export Subsidies

Export Subsidies are generally direct government payments or other inducements given to domestic producers of goods that are sold in foreign market. GATT also recognizes the export subsidies but it may disturb trade and normal commercial competition and hinder the achievement of GATT fair trade objectives.

Subsidies are the major instrument of trade policy. They have been used in different countries as a means of promoting exports and discouraging imports. In the context of imports, subsidy has been found to be a useful method of protection particularly in the following circumstances:

(i) When domestic production equals to a small fraction of total domestic demand.

(ii) When commodities are essential raw materials.

(iii) Cost of the commodity come down.

Disadvantages of Subsidies

(i) To handle the subsidies is a big administrative problem.

(ii) Payment of subsidies to individuals or industrial undertakings requires careful control.

(iii) High order of efficiency is required to distribute the subsidies.

(iv) Mismanagement is possible in disbursing the subsidies.

(v) Subsidies are distributed by the government so it is less secure than protective.

(vi) Subsidies are directly connected with the budgetary position.

(vii) Some countries instead of giving subsidies impose tax to generate revenue.

(viii) Direct cash subsidies to exporters for price discrimination are given only sparingly.

(ix) Many developing countries do not give subsidy directly. Instead of that, they subsidize export promotion efforts.

(x) Developing countries provide direct cash assistance for export publicity tours abroad.

Voluntary Export Restraint

A **voluntary export restraint** (VER) or voluntary export restriction is a government-imposed limit on the quantity of some category of goods that can be exported to a specified country during a specified period of time.

Typically VERs arises when industries seek protection from competing imports from particular countries.

Administrative Policies Regarding Export Promotion

Besides the formal instruments of trade policy, governments of all types sometimes use a range of informal or administrative policies to restrict imports and boost exports. These policies are bureaucratic rules that are designed to make it difficult for imports to enter their country. Japan for ego is the master in such type of trade barriers.

One example is that of Tulip bulbs, Netherlands exports Tulip bulbs to every country except Japan. Japanese customs inspectors insist on checking every bulb by cutting then vertically down the middle.

Government Intervention

We have seen the various instruments of trade policy that government can use. Sometimes govt. intervention is required in international trade. There are two types of arguments for government intervention: Political and Economic.

Political intervention is required for protection to certain groups within a nation' normally producers.

Economic interventions are basically concerned with boosting the overall wealth of a nation.

Political arguments for intervention are as follows:

(i) Protection for a certain group.

(ii) Protection of jobs for weaker sections of the society.

(iii) Protection of industries is important for national security.

(iv) Political interventions are not always based on careful reasoning.

(v) Voluntary export restraints are applied for protection of industries.

(vi) Protection of jobs and industries through government intervention.

INTERNATIONAL BUSINESS MODULE – III

ORGANIZATIONAL STRUCTURES

Every international business firm has to face various issues related to organizational policies. These organizational issues are to be addressed carefully in order to keep the business healthy and profitable. Although there are numerous issues, both small and big, we will primarily concentrate only on the major issues that need to be addressed.

Centralization vs. Decentralization

Centralization is the systematic and consistent reservation of authority at central points in the organization. In **centralization,** the decision-making capability lies with a few selected employees. The implications of centralization are

- Decision making power is reserved at the top level.
- Operating authority lies with the mid-level managers.
- Operation at lower level is directed by the top level.

Almost every important decision and operational activities at the lower level are taken by the top management.

Decentralization is a systematic distribution of authority at all levels of management. In a decentralized entity, major decisions are taken by the top management to build the policies concerning the entire organization. Remaining authority is delegated to the mid- and lower-level managers.

Use of Subsidiary Board of Directors

International firms, especially the fully-owned ones, usually have a board of directors to oversee and direct the top-level management. The major responsibilities of board-members are to −

- Advice, Approve and Appraise local management.
- Help the management unit in providing response to local conditions.
- Assist the top management in strategic planning.
- Supervise the firm's ethical issues.

The four different kinds of organizational structure are as mentioned below:

1. Administrative Structures

Administrative structures include a specific level of regularization. They are preferably suitable for greater scale or larger multifaceted organizations, most compelling on an extraordinary structure. The stress between non- administrative and administrative structures is resounded difference between gradual and automatic structures.

2. Functional Structure

Functional Structure organizational is a structure which includes undertakings like supervision, direction, management, and allocation of responsibilities. The organizational structure selects how the processes and presentations of the organization can carry. The communication organization structure narrates to how the associate in a company are gathered and to whom can they report. One unoriginal means of establishing individual is done function. Few collective activities in a company contain marketing, HR, manufacture, and bookkeeping. The benefits and importance of functional structure include quick decision making as the members of the group are able to interconnect effortlessly with each other. Also, since the members already own same sets of skill and interests' individuals in this type of structures can easily learn from each other.

3. Divisional Structure

The divisional structure which is also called as product structure is an arrangement of a business that breakdowns the organization into separation which is self-concerned with. A division is self-oriented and includes groups of functionalities that execute to make a product. It plans to operate and enter like a distinct revenue or business center.

4. Matrix Structure

The roles and duties incline to be considerably more complex defined in the matrix structure. The matrix structure bonds employees by both function as well as the product. A matrix company over and over again exploits and develops groups of staffs to accomplish the task, so as to take advantage of the power and in order to hide the weaknesses, of reorganized and practical forms.

CONTROL MECHANISMS

Control mechanisms play an important role in any business organization, without which the roles of managers get constrained. Control is required for achieving the goals in a predefined manner because it provides the instruments which influence the performance and decision-making process of an organization. Control is in fact concerned with the regulations applied to the activities within an organization to attain expected results in establishing policies, plans, and practices.

Control mechanisms can be set according to functions, product attributes, geographical attributes, and the overall strategic and financial objectives.

Objectives of Control

There are three major objectives for having a control mechanism in an international firm. They are −

- To get data and clues for the top management for monitoring, evaluating, and adjusting their decisions and operational objectives.

- To get clues based on which common objectives can be set to get optimum coordination among units.
- To evaluate the performance metrics of managers at each level.

Types of ControlMechanisms

There are various modes of control. The most influential ones are the following −

Personal Controls

Personal controls are achieved via personal contact with the subordinates. It is the most widely used type of control mechanism in small firms for providing direct supervision of operational and employee management. Personal control is used to construct relationship processes between managers at different levels of employees in multinational companies. CEOs of international firms may use a set of personal control policies to influence the behavior of the subordinates.

Bureaucratic Controls

These are associated with the inherent bureaucracy in an international firm. This control mechanism is composed of some system of rules and procedure to direct and influence the actions of sub-units.

The most common example of bureaucratic control is found in case of **capital spending rules** that require top management's approval when it exceeds a certain limit.

Output Controls

Output Controls are used to set goals for the subsidiaries to achieve the targeted outputs in various departments. Output control is an important part of international business management because a company's efficiency is relative to bureaucratic control.

The major criteria for judging output controls include productivity, profitability, growth, market share, and quality of products.

Cultural Controls

Corporate culture is a key for deriving maximum output and profitability and hence cultural control is a very important attribute to measure the overall efficiency of a firm. It takes form when employees of the firm try to adopt the norms and values preached by the firm.

Approaches to ControlMechanisms

There are seven major approaches for controlling a business organization. These are discussed below −

Market Approach

The market approach says that the external market forces shape the control mechanism and the behavior of the management within the organizational units of an MNC. Market approach is applied in any organization having a decentralized culture.

In such organizations transfer prices are negotiated openly and freely. The decision-making process in this approach is largely directed and governed by the market forces.

Rules Approach

The rules approach applies to a rules-oriented organization where a greater part of decision-making is applied to strongly impose the organizational rules and procedures. It requires highly developed plan and budget systems with extensive formal reporting. Rules approach of control utilizes both the input and output controls in an organized and exclusively formalized manner.

Corporate Culture Approach

In organizations that follow the corporate culture approach, the employees internalize the goals by building a strong set of values. This value-syndication influences the operational mechanism of the organization. It has been observed that even when some organizations have strong norms of behavioral controls, they are informal and less explicit. Corporate culture approach requires more time to bring the aimed changes or adjustments in an organization.

Reporting Culture

Reporting culture is a powerful control mechanism. It is used while allocating resources or while the top management wants to monitor the performance of the firm and the employees. Rewarding the personnel is a common practice in such approaches of control. However, to get the maximum out of reporting approach, the reports must be frequent, correct, and useful.

Visits to Subsidiaries

Visiting the subsidiaries is a common control approach. The disadvantage is that all the information cannot be exchanged via visits. Corporate staffs usually and frequently visit subsidiaries to confer and socialize with the local management. Visits can enable the visitors to collect information about the firm which allows them to offer advice and directives.

Management Performance Evaluation

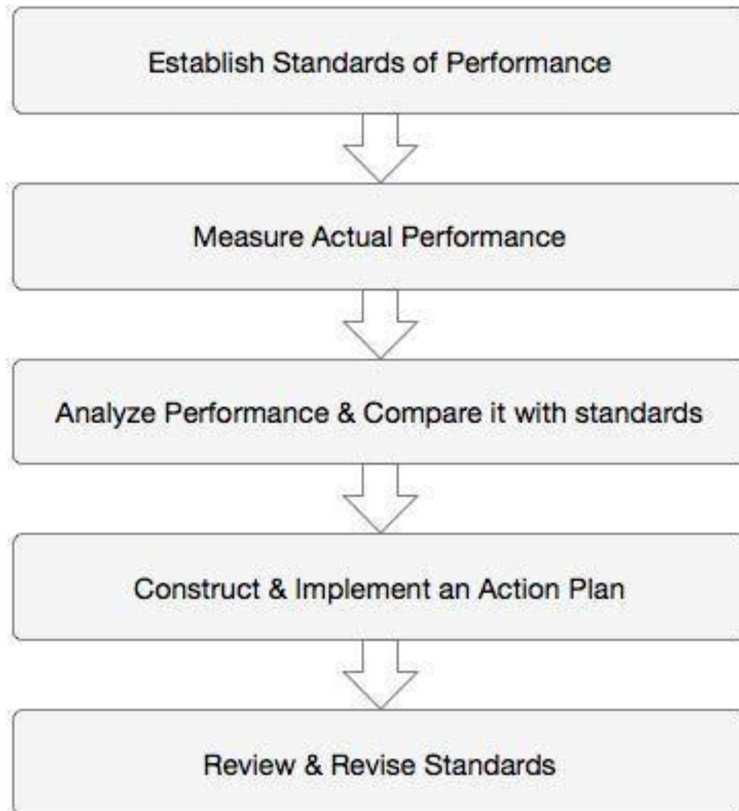
Management performance Evaluation is used to evaluate the subsidiary managers for the subsidiary's performance. However, as decision-making authority is different from the operational managers, some aspects of control cannot be managed via this approach. Slow growth rates of firms and risky economical and political environment requires this kind of approach.

Cost and Accounting Comparisons

Cost and Accounting Comparisons is a financial approach. It arises due to the difference in expenditure among various units of the subsidiaries. A meaningful comparison of the operating performances of the units is necessary to get the full output from this approach. Cost accounting comparisons use a set of rules that are applicable to the home country principles to meet local reporting requirements.

PERFORMANCE ISSUES

It is an important part of every business organization to measure the performance of both employees and the firm as a whole. We will, however, restrict our focus on organizational performance measurement. The standard process of measuring the performance of a global business is as shown in the following diagram −



The prominent features of each stage are discussed below.

Establish Standard of Performance

Standard of performance is applicable to cost, quality, and customer service. More than one standard may be necessary because they reflect expected levels of various units of the manufacturing performance. This includes process yields, product quality, overhead spending levels, etc.

Measure Actual Performance

To measure actual performance, the use of automated data collection systems is suggested to gather information. A standard cost measurement system includes man-hours, machine-hours, and material usage.

Analyze the Performance and Compare it with standards

There must be some set standards to compare the actual performance. The standards should be realistic and achievable. The results of the comparison can be used to apply further rules, targets, and reporting.

Construct and Implement an Action Plan

Constructing and implementing an action plan is the key to success. **Variance analysis** can be used to detect potential problem areas. Finding the source of the problem and improving the situation may be useful. Its effectiveness depends on the management's adaptability to the information obtained.

Review and Revise Standards

Review and revise is an important step, as modern organizations are in a constant state of change. If the variances are significant, the performance standards can be adjusted. Effective Performance Measurement must be integrated with the overall strategy. This step requires various financial and non-financial indicators.

Effective Performance Measurement System

For getting an effective performance measurement system −

- The measurement objectives must be owned and supported throughout the organization.
- The process must be applied top-down for maximum benefits. The measures applied must be fair and achievable.
- The measurement system and the reporting structure must be simple, clear, and recognizable.
- The firms need to prioritize and focus to address only the key performance indicators.

Performance Evaluation System

A performance evaluation system must contain periodic review of operations so that the objectives of the firm are accomplished. It is important to have the accounting information to evaluate domestic and foreign operations' costs and profitability.

It is not all that simple to measure the performance of an individual, a division, a subsidiary, or even a company as a whole. It is a lengthy and hectic process. The objectives of performance evaluation are to –

- Find the economic performance of the firm
- Analyze each unit's management performance
- Monitor the progress of objectives, including the strategic goals
- Assist in appropriate allocation of resources

Financial and Non-Financial Measures of Evaluation

ROI (Return on Investment) − ROI is the most common method to evaluate the performance of an international firm. It shows the relationship between profit to invested capital and encompasses almost all important factors related to performance. An improved ROI can act as a logical motivator of the managers.

Budget as Success Indicator − Budget is an accepted tool for measuring and controlling the operations. It is also used to forecast future operations. A budget is a clearly expressed set of objectives that guide the managers to set their individual performance standards. A good local or regional budget helps the company to facilitate its strategic planning process smoothly.

Non-Financial Measures − the major non-financial measures that can be used to evaluate performance are − Market Share, Exchange Variations, Quality Control, Productivity Improvement, and Percentage of Sales.

Types ofPerformance Evaluation Systems

Performance evaluation systems can be of the following types −

- **Budget Programming** − Budget programming is prepared for operational planning and financial control. It is an easy-to-calculate system to evaluate the variance. It is used to measure the current performance in relation to some comparable performance metric from the past.
- **Management Audit** − It is an extended form of financial audit system which monitors the quality of management decisions in financial operations. It is used for appraisal and performing audit for management.
- **Programme Evaluation Review Technique (PERT)** − Based on CPM, PERT delineates a given project or program into network of activities or sub-activities. The goal is to optimize the time spent by the managers. In this process, performance is measured by comparing the scheduled time and the cost allocated with the actual time and the cost.
- **Management Information System (MIS)** − MIS is an ongoing system designed to plan, monitor, control, appraise, and redirect the management towards pre-defined targets and goals. It is a universally acceptable practice which encompasses the financial, budgeting, audit and control systems of the PERT.

PRODUCTION ISSUES

Production is the core of any business organization having its operations on an international scale. International business firms must look closely at production factors for profitability and sustainability. Production refers to manufacturing, acquiring, and developing products for the business market.

Factors that AffectProduction

There are three major areas an international organization must focus on in order to increase its production efficiency. They are −

- Facility Location
- Scale of Operation
- Cost of Production

We will look into each of them in the following sections.

Facility Location

Facility Location refers to the appropriate location for the manufacturing facility; it should have optimum access to customers, workers, transportation, etc.

The main goal of an organization is to satisfy and delight customers with its product and services. The manufacturing unit plays a major role in this direction. One of the most important factors for determining the success of a manufacturing unit is its location.

To get commercial success and retain its competitive advantage, any international business firm would pay attention to the following critical factors while choosing its business location −

- **Customer Proximity** − Customer proximity is important to reduce transportation cost and time.
- **Business Area** − having other manufacturing units of similar products around the business area is conducive for facility establishment.
- **Availability of Skilled labor** − There should be skilled labor available in and around the facility location.
- **Free Trade Zone** − Free-trade zones usually promote and augment the establishment of manufacturing facility by offering incentives in custom duties and applicable levies.
- **Suppliers** − Continuous availability and quality supply of the raw materials influences in determining the location of production facility.
- **Environmental Policy** − as pollution control is very important, understanding of environmental policy for the facility location is critical.

Scale of Operations

Scale is the synonym for size in business. Business organizations can leverage on their size by making dealings, favorable terms, and volume-discounts with other firms.

Operating the businesses at large scale means allocating and optimizing the resources to obtain the greatest results and volumes in the entire market segment. It is linked with optimization, not duplication, of efforts. Keeping costs under control while increasing the sales offers the opportunity for reducing costs and acquiring new customers, and more market share, without lowering the average margin (economies of scale).

Small-Scale Business − Also termed a small business, a small-scale business employs a small number of workers and does not have a high volume of sales. The U.S. Small Business Administration states that small-scale businesses have fewer than 500 employees. Financially, a non-manufacturing small-scale business is one that earns below or equal to $7 million a year.

Large-Scale Business − Based on the home country and the industry, a small-scale company usually employs between 250 and 1,500 people. Anything above that is a large-scale company.

Economies of Scale − It refers to the cost advantages that a business obtains due to its size, output, or scale of operation. Usually, cost per unit generally decreases with the increasing scale, as fixed costs are spread out over more products.

Cost of Production

It is a cost incurred by a company in manufacturing a product or delivering a service. Production costs depend on raw material and labor. To determine the cost of production per unit, the cost of production is divided by the total number of units produced. It is important to know the cost of production to better price an item or a service and to decide its total cost to the company.

Cost of production includes both Fixed and Variable Costs.

- **Fixed costs** do not change with the level of output. They usually include rents, insurance, depreciation, and set-up costs. Fixed costs are also known as **overhead** cost.
- **Variable** costs refer to those costs which vary with the level of output, and are also known as **direct costs** or **avoidable costs**. Examples include fuel, raw materials, and labor costs.

Make-or-Buy Decisions

Make-or-buy decisions are taken to arrive at a strategic choice between manufacturing an item internally (in-house) or buying it externally (from an external supplier). The buy side of the decision is also known as **outsourcing**. Make-or-buy decisions of a firm is important when it has developed a product or part – or significantly modified a product or part – but is having problems with the current suppliers, or has decreasing capacity or changing demand.

The major reasons for manufacturing an item in house include the following −

- Cost attributes (less expensive to make)
- Intentions to integrate the operations
- Productive use of excess plant capacity (using present idle capacity)
- For direct control over production / quality
- When design secrecy is applicable to protect proprietary technology
- Unreliable / incompetent suppliers
- Very small quantity of production
- Controlling lead time, transportation, warehousing costs
- Political, social, or environmental pressure

Buy decisions are applicable under the following conditions −

- Insufficient local expertise
- Cost considerations (less expensive)
- Small-volume requirements

- Limited production or insufficient capacity
- Intentions to maintain a multiple-source policy
- Indirect managerial control factors
- Procurement and inventory factors
- Brand preference

SUPPLY CHAIN ISSUES

Globalization is changing the way the international firms used to deal with their supply chain networks. This is happening because companies are actively seeking to compete and gain market share. Global companies nowadays manage multiple supply chains, not only to deliver goods on time, but to meet diverse customer and supplier wants related with pricing and packaging. Personalizing the offerings for various customer clusters is necessary to address these issues.

Volatility of markets, economic contractions and mediocre recovery cycles influence distribution, manufacturing, invoicing and sourcing. Reaching out to encompass new markets brings complex taxation, invoicing and localization burdens. Moreover, dispersed segments of markets ask for different pricing models and services. Hence, optimizing the supply chain is necessary to stay competitive.

Globalization and its Effect on Supply Chain

Many businesses tend to apply outdated processes and technologies to global supply chain operations. Many times, available systems are not compatible with the modern demands. Lack of understanding of current situations and contemporary supply chain can be disastrous. It can result in a rise in costs and decreased efficiency. With the expansion of logistics, the ability to quickly estimate the cost and service implications must increase.

An optimized global supply chain can help a company in the following areas −

- **Reduced Costs** − Companies accessing information relating to suppliers make better procurement decisions. Online supplier and buyer community management can reduce supplier sourcing and procurement costs.
- **Increased Transparency** − Being a single point of access for supplier information as well as buyer-supplier communities is important. International supply chain operators can locate reliable suppliers regardless of location preferences with a global approach and transparent policy.
- **Lower Risk** − An optimized supply chain lets the supplier meet financial, legal, safety, quality, and environmental regulations. As the regulations differ widely, flexibility becomes the key to risk management.
- **Support Legacy & New Products** − Contemporary global supply chains require a billing partner and a supplier settlement platform. The platform needs to take care

of taxation, invoicing and other crucial functions. It must encompass multiple fluid business-models to let the company reach international markets.

- **Solutions to Global Supply Chain Challenges** − While looking for growth and quick expansion, companies must consider deeply about what their current supply chains are capable of. They must assess whether their capabilities are enough to meet global competition. In order to support the existing and future business objectives, companies must reconsider the management processes and implement best practices which are more flexible.

GLOBAL MARKETING MIX

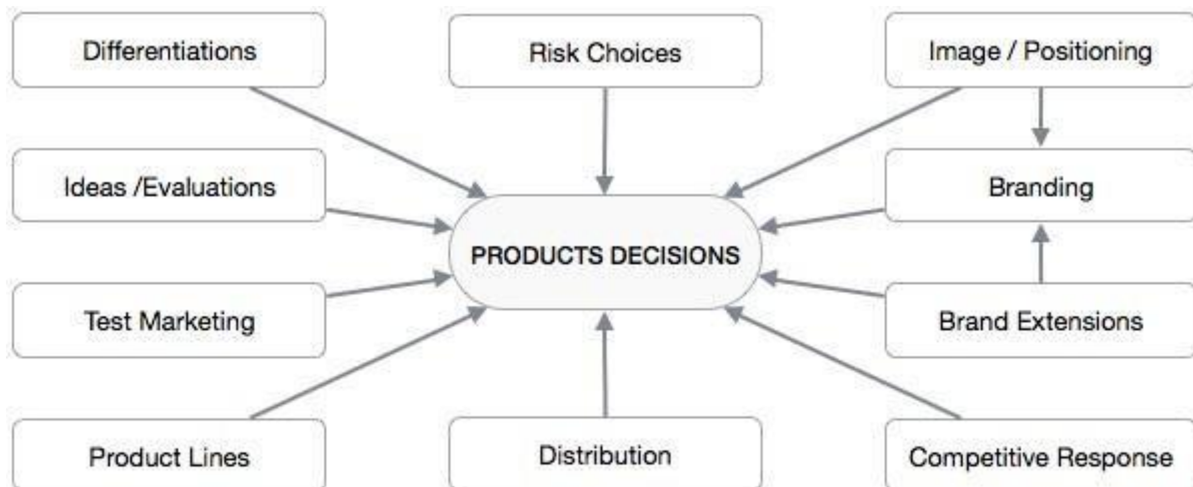
Global Marketing combines the promotion and selling of goods and services with an increasingly interdependent and integrated global economy. It makes the companies stateless and without walls.

The **4P's** of Marketing − **product, price, place, and promotion** − pose many challenges when applied to global marketing. We take each one of the **P's** individually and try to find out the issues related with them.

Global Marketing Mix: ConsumerProducts

The product and service mix is one of the most important ingredients for the global marketer today. The diverse demand for products and services in the era of globalization is mind-blowing. Presence of industrialized and emerging markets, increasing purchasing power, and the growth of Internet has made the customers aware, smart, and more demanding. The result is a greater competition between firms.

Here are the important factors to consider when going global with a product or service.



The global consumer makes purchasing decisions to get the best quality products at the most affordable price. They have information available in abundance, thanks to the Internet. Therefore, **innovation** takes center-stage to gain adequate attention from potential consumers.

A global marketer must be **flexible enough to modify the attributes** of its products in order to adapt to the legal, economic, political, technological or climatic needs of a local market. Overall, global marketing requires the firms to have available and specific processes for product adaptation for success in new markets.

Culture can differentiate a standardized product from an adapted one. Making cultural changes in product attributes is like introducing a new product in your home country. The product should meet the needs, tastes, and patterns that are permitted by the market culture.

Lastly, it is essential to understand that a product or service is not just one "thing." It should be seen as a part of the whole marketing mix so that a great synergy can be built among different strategies and actions.

Global Marketing Mix: Price

Pricing is a crucial part of the marketing mix for international firms. Pricing techniques play a critical role when a company wants to penetrate into a market and expand its operations.

Drivers in Foreign Market Pricing

The most important factors that decide the prices are labeled the **4 C's** −

- Company (costs, company goals)
- Customers (price sensitivity, segments, consumer preferences)
- Competition (market structure and intensity of competition)
- Channels (of distribution)

International Pricing Challenges

Global firms face the following challenges while pricing their products and services to suit the requirements of international market −

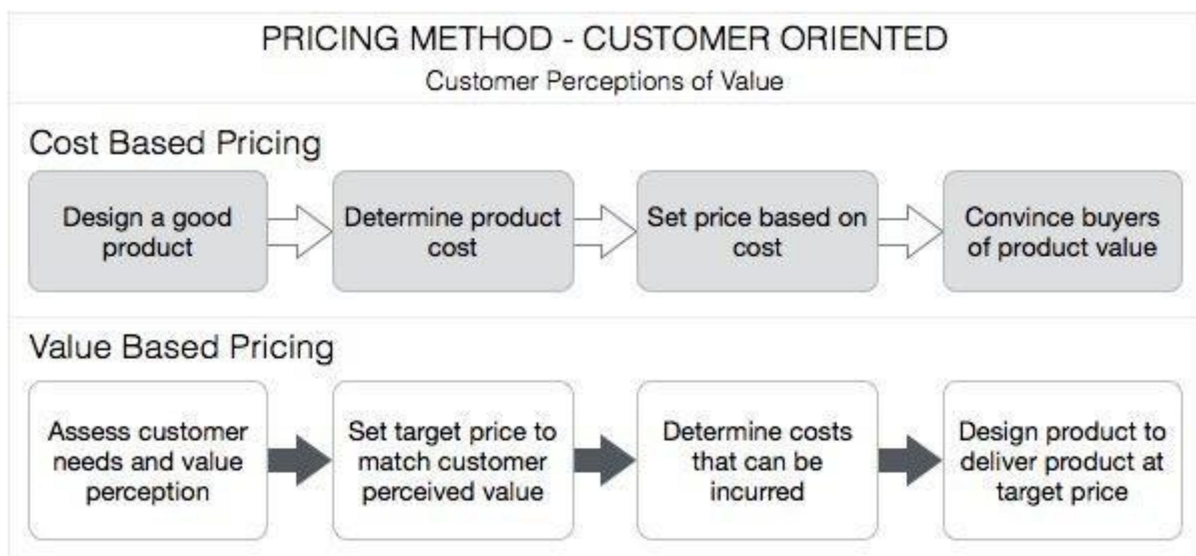
- **Export Price Escalation** − Exporting includes more steps and higher risks than domestic sale. To make up for shipping, insurance and tariffs, and foreign retail prices, the export price may be much higher than domestic country. It is important to know whether external customers are willing to pay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

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

- **Currency Movements** − Exchange rates being unstable, setting a price strategy that can get rid of fluctuations gets difficult. Key considerations include what

proportion of exchange rate gain or loss should be transferred to customers (the pass-through issue), and finding which currency price quotes are given in.

- **Transfer Pricing** − Transfer prices are the charges for transactions that involve trade of raw materials, components, finished products, or services. Transfer pricing include stakeholders, such as the company, local managers, host governments, domestic governments, and joint-venture partners. Tax regimes, local conditions, imperfections, joint venture partners and the morale of managers affect transfer pricing.
- **Anti-dumping Regulations** − Dumping occurs when imports are sold at an unfair and very low price. Recently countries have adopted anti-dumping laws to protect their local industries. Anti-dumping laws should be considered when deciding global prices.
- **Price Coordination** − Price coordination is the relationship between prices charged in different countries. It is an important consideration while deciding the global pricing model. Price coordination includes the following factors − Nature of customers, Product differentiation amount, Nature of distribution channels, Competition type, Market Integration, Internal organizational characteristics, and Government regulations.
- **Countertrade** − Countertrades are unconventional trade-financing transactions including non-cash compensation. A monetary valuation can however be used in countertrade for accounting purposes. In dealings between sovereign states, the term bilateral trade is generally used. Examples include clearing arrangements, buybacks, counter purchases, switch trading, and offsets.



Global Marketing Mix: Promotion

Promotion comes into picture when a global company wants to communicate its offering to potential customers. How an organization chooses to promote its products and services can have a direct and substantial impact on its sales.

Advertising and Culture

Advertising can create a popular culture and a culture may influence the ad as well. Culture's impact in advertising is prevalent, especially in culturally-sensitive issues like religion and politics.

Setting a Budget

A global marketer can consider budgeting rules such as percentage of sales (creating budget as a percentage of sales revenues), competitive parity (taking competitor's ad spending as a benchmark), or objective-and-task (treating promotional efforts to achieve stated objectives). Global markets use **three approaches** to reach allocation decisions −

- In **bottom-up budgeting,** the units independently determine the market budget and request resources from headquarters.
- In **top-down budgeting,** the headquarters set a total budget and split up the resources.
- Decisions may also be made at a **regional level** and submitted to the headquarters for their approval.

Promotional Strategy

When global marketers choose a standardized approach, the same global campaign is applied throughout all countries.

- **Advantages** − Achieving economies of scale in ad campaigns to reduce cost, maintaining a consistent brand image.
- **Barriers** − Cultural differences resulting in negative or ineffective consumer response, advertising laws and regulations, variations in degree of marketing development.

Assessing Global Media Decisions

Global media decisions are a big concern for global firms. The media buying patterns vary across countries. A global marketer must find the best media channels in a market.

Ad Regulations

Foreign regulations on advertisements may be present in a specific country. Research of the laws in the country of operation is necessary before developing a campaign, to avoid legal implications and waste of time and money.

Choosing an Agency

Choosing an ad agency may prove more effective due to their understanding of the country and market they are doing business in.

Other Communication Options

Sales events, direct marketing, sponsorships, mobile marketing, product placement, viral marketing, and public relations and publicity are also applicable.

Globally Integrated Marketing Communications (GIMC)

A GIMC is a system of promotional management that coordinates global communications - horizontally (from country to country) and vertically (promotion tools). GIMC is meant to harmonize the promotional and communication disciplines in every way. All communication vehicles may be integrated so that they convey the single idea to all concerned in a unified voice.

Global Marketing Mix: Distribution

In order to be successful in a global market, a marketer must make its products and accessible to customers at all costs. Distribution channels make up the "place" in the 4 P's of the marketing mix (along with Product, Price, and Promotion).

Distribution Processes and Structures

The distribution process deals with product handling and distribution, the passage of ownership (title), and the buy and sell negotiations.

Negotiations take place between the producers and the middlemen and then between the middlemen and the customers.

Traditionally, **import-oriented distribution** structures relied on a system where importers controlled a fixed supply of goods. The marketing was based on the idea of limited suppliers, high prices, and smaller number of customers. Today, the import- oriented model is hardly used. Channel structures have become more advanced with overall development.

Distribution Patterns

To understand a foreign distribution system, marketers should never believe that it is the same as the domestic one. Many distribution patterns exist in retailing and wholesaling. Size, patterns, direct marketing, and the resistance to change affect the composure of distribution channels.

- **Retail size and pattern** − Company's may either sell to large, dominant retailers directly or distribute to smaller retailers.
- **Direct marketing** − the challenge in underdeveloped nations is handled through direct marketing. Direct marketing occurs when consumers are targeted through mail, telephone, email, or door-to-door selling. This process also doesn't take retailer and wholesaler types into consideration.

Choosing Your Middleman

The channel process starts with manufacturing and ends with the final sale to the customer. It is most likely to counter many different middlemen in the process. There are three types of middlemen in distribution channels −

- **Home-Country Middlemen** − they provide marketing and distribution services from a domestic base in the home country. The parties usually relegate the foreign-market distribution to others; including manufacturer or global retailers, export management companies, or trading companies.

- **Foreign-Country Middlemen** − for a greater control, foreign-country middlemen are hired who can create a shorter channel and have more market expertise.
- **Government-Affiliated Middlemen** − Government-affiliated middlemen are often responsible in distribution for the government's use.

Factors Affecting Choice of Channels

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

- The specific target market within and across countries.
- The goals in terms of volume, market share, and profit margin.
- The financial and organizational commitments.
- Control of the length and characteristics of the channels.

Application of 4P's

The following illustration depicts the global marketing mix of McDonald's. It shows how McDonald's varies its marketing strategy according to the requirements of different local markets.

McDonald's Global Marketing

Marketing Mix Element	Standardization	Localization
Product	Big Mac	McAloo Tikka Potato Burger (India)
Promotion	Brand Name Advertising Slogan: I'm Loving It.	Slang Macca's (Australia) MakDo (Phillipines)
Place	Free Standing	Home Delivery (India) Swiss Rail System Dining Cars
Price	Big Mac is $3.10 in US & Turkey	$5.21 (switzerland) $1.31 (China)

FINANCIAL ASPECTS

Foreign Investment by InternationalCompanies

The proliferation of MNCs began 200 years back, but then, foreign investments were quite limited. Investments were made through portfolio and long-term Greenfield or joint venture investments were low. Globalization, however, has led MNCs to become more dominant players in the global economy.

The end of the cold war that brought the idea of liberalization of the developing markets and opening of their economies has played a major role in international investments. With the vanishing of foreign investment barriers, privatization of the state economic organizations and development of FDI policies, MNCs have started investing aggressively.

FDI has become by far the single largest component of the net capital inflows. It also has effects on the human capital of the economies. Countries benefit substantially from the investment. Investments in developing countries have integrated the developing economies with other countries of the world. This is often referred to as economic openness.

Note − Seventy percent of world trade is controlled by just 500 of the largest industrial corporations. In 2002, the combined sales volume of the top 200 companies was equivalent to 28% of the overall GDP of the world.

International Investment Outcomes

International corporations have shaped the global economy in the 20th century. Now, any of the world's Top 100 or global companies exceeds the GDP of many nations. The MNCs are also creating most of the output and employment opportunities in the world.

The MNCs have started building local relationships and establishing a strong local presence through FDI's to benefit from different advantages, where the countries focusing on getting more FDI investment have become busy with giving MNCs more freedom and assistance in seeking economic cooperation with them.

As the importance MNCs in the global economy increases, companies have been both criticized and appreciated. The growing shares of MNCs in developing economies and the impact of their decisions in overall economic conditions of the host countries have been under review.

- **Cons** − MNCs are mainly criticized for disappearance of domestic players due to their global brand, use of latest technology, marketing and management skills, and economies of scale which domestic firms cannot compete with. MNCs have also been criticized for controlling the domestic economic policies and taking actions against the developing country's national interests.
- **Pros** − The investments have brought technological and managerial assets to developing countries. Employment with a better-trained labor force, a higher national income, more innovations, and enhanced competitiveness are some of the positive contributions of MNCs to developing countries.

Sources of Funds

- **Export-Import Banks** − These banks provide two types of loans − Direct loans to foreign buyers of exports, and Intermediary loans to responsible parties, such as foreign government-lending agencies which then re-lend to foreign buyers of capital goods and related services.
- **With-in company loans** − New companies raise funds through external sources, such as shares, debentures, loans, public deposits, etc., while an existing firm can generate funds through retained earnings.
- **Eurobonds** − International bonds are denominated in a currency of non-native country where it is issued. This is good in providing capital to MNCs and foreign governments. London is the center of the Eurobond market, but Eurobonds may be traded throughout the world.
- **International equity markets** − International businesses can issue new shares in a foreign market. Shares are the most common tool for raising long-term funds from the market. All companies, except those that are limited by a guarantee, have a statutory right to issue shares.
- **International Finance Corporation** − Loans from specialized financial institutions and development banks or from commercial banks are also tools for generating funds.

Foreign Exchange Risks

There are three types of risks associated with foreign exchange −

- **Transaction risk** − This is the risk of an exchange rate change on transaction date and the subsequent settlement date, i.e., it is the gain or loss arising on conversion.
- **Economic risk** − Transactions depend on relatively short-term cash flow effects. However, economic exposure encompasses the longer-term effects on the market value of a company. Simply put, it is a change in the present value of the future after-tax cash-flows for exchange rate changes.
- **Translation risk** − The financial statements are usually translated into the home currency to consolidate into the group's financial statements. It can pose a challenge when exchange rates change.

HRM ASPECTS

Recruitment and Selection

Recruitment is a process of attracting a pool of qualified applicants. **Selection** is choosing applicants from this pool whose qualifications match the job requirements most closely. Traditionally, there are three types of employees −

- **Parent Country National** − the employee’s citizenship is same with the organization.

- **Host Country National** − the employee is local for the subsidiary.
- **Third Country National** − the employee is from a different country, i.e., not where the organization is registered / based and also where the subsidiary of the organization is not located.

Staffing and managing approaches strongly affect the type of employee the company looks for. In **Ethnocentric approach,** the parent country nationals are chosen for headquarters and subsidiaries. In **polycentric approach,** host country nationals work in the subsidiaries, while parent country nationals are chosen for headquarters. An organization with a **geocentric approach** chooses employees purely based on talent, regardless of their origin type.

A balance between internal organizational consistency and local labor practices policy is a goal during recruitment. People in achievement-oriented nations consider skills, knowledge, and talents while hiring a new employee.

Development & Training

The overall aim of the development function is to provide adequately trained personnel in a company as well as to contribute to better performance and growth with their work. At the international level, human resource development function manages −

- Training and development for global employees
- Special training to prepare expatriates for international jobs
- Development of globally efficient managers

Creation and transfer of international human resource development programs may be carried out in two ways −

- In **centralized approach,** headquarters develop trainings and trainers travel to subsidiaries, often adapting to local situations. This fits mostly with the ethnocentric model. A geocentric approach is also centralized, but the training inputs come from both headquarters and subsidiaries staff.
- In **decentralized approach,** training is carried out on a local basis, which follows a polycentric model. In decentralized training, the cultural backgrounds of employees and corporate trainers are same. Training material and techniques are usually local and for use in their own area.

Performance Evaluation

In companies, performance evaluation is most frequently carried out for administration or development purpose.

For administration purposes, performance evaluation is done when the decisions on work conditions of employees, promotions, rewards and/or layoffs are in question. Development intention is oriented to the betterment of work performance of employees, as well as to the enhancement of their abilities. It is also a way for advising employees regarding corporate behavior.

Performance evaluation can be quite challenging, especially when it carried out at an international level. The international organization must evaluate the employees from different countries. Consistency across subsidiaries for performance comparisons with contrasting cultural background makes the evaluation meaningful. As with other functions, the approach to performance evaluation depends on the organization's overall human resource management strategy.

Management of Expatriates

Expatriates management is one of the most important issues in international business. The most important issues related to Management of Expatriates are the following −

The Reasons for Expatriate Failure

In international companies, the high failure rate of expatriates can be contributed to six factors − career blockage, culture shock, lack of cross-cultural training, an overemphasis on technical qualifications, using international assignments to get rid of problematic employees, and family problems.

Cross-Cultural Adjustment

Expatriates and their families need time to become familiar with their new environment. The **culture shock** occurs when after some time, the expatriates find new job conditions unattractive. It usually takes three to six months after arrival, to get out of the culture shock.

Expatriate Re-Entry

After the expatriate completes his assignment and returns home, the work, people, and general environment becomes unfamiliar. The expatriate is generally unprepared to deal with **reverse culture shock**.

Selection of Expatriates

The choice of employee for an international assignment is a critical decision. To choose the best employee for the job, the management should −

- Make cultural sensitivity a selection criterion
- Have expatriates in selection board
- Look for international experience
- Hire foreign-born employees as "expatriates" in future
- Screen spouses and families too

Expatriate Training

Expatriates when trained to prepare for work abroad are more successful. Lack of training can lead to expatriate failure. **Cross-cultural training** (CCT) is very important. It prepares to live and work in a different culture because coping with a brand new environment can be challenging.

Expatriate Evaluation and Remuneration

There are three common aspects that determine the remuneration of expatriates. In a **home-based policy,** employees' remuneration is according to their home countries. The **host-based policy** sets salaries according to the norms of the host country. Finally, region also effects in determining the remunerations.

Remuneration for foreign employees depends on their relocation − whether it is within their home region or in another region. With this approach, closer to home (within the region) jobs fetch lower remuneration than the away (outside the region) jobs.