MBA SEMESTER 3

INTERNATIONAL BUSINESS

(4539281)

MODULE 1

CHAPTER 1

GLOBALIZATION AND INTERNATIONAL BUSINESS

INTERNATIONAL BUSINESS AND GLOBALIZATION

● What is International Business?

"All commercial transactions—including sales, investment and transportation —that takes place between two or more countries is known as International Business."

International business relates to any situation where the production or distribution of goods or services crosses country borders. International business involves transactions across the national boundaries. It involves not only the international movements of goods and services, but also of capital personnel, technology and intellectual property like patents, trademarks, know-how and copy rights.

The world has become a "global village." The business has expanded and is no longer restricted to the physical boundaries of the country. Even countries that were self-sufficient now rely on other countries to purchase goods and services. They are also ready to supply goods and services to developing countries. This is due to the development of new communication modes and infrastructure equipment as a faster and more efficient means of transportation. That brought the nations closer to each other. In addition to technological

developments, the World Trade Organization (WTO) infrastructure and communication efforts implemented by governments of various countries are also one of the main reasons for increasing trade exchanges between countries.

Although business has been conducted on an international scale for many years, international business has gained more significance only in recent years because of the emergence of multinational corporations in some of the developing countries.

- **What is Globalization?**

Globalization refers to the broadening set of interdependent relationships among people from different parts of a world that happens to be divided into nations.

According to WHO, globalization can be defined as " the increased interconnection and interdependence of peoples and countries. It is generally understood to include two inter-related elements: the opening of international borders to increasingly fast flows of goods, services, finance, people and ideas; and the changes in institutions and policies at national and international levels that facilitate or promote such flows."

- **Difference between Global business and International business:**

In Global business company operates facilities in many countries around the world.

In International business company sells products worldwide but has facilities only in home country.

- **Factors driving Globalization:**

1. Expansion of Technology:

Technology is the vital force in the modern form of business globalization. Technology has revolutionized the global economy and has become critical competitive strategy. Expansion in Technology helped many firms to go global.

Technology has helped us in overcoming the major hurdles of globalization and international trade such as trade barrier, transportation cost and delay in information exchange. Technology has enabled the software experts to work collaboratively over the network with companies from around the world. The technological advancement has helped a lot in creation and growth of global market.

2. Liberalization of cross-border trade and resource movements:

Liberalization of trade and investment policies has helped the globalization process by making foreign trade and investment easier. Earlier, several developing countries had placed barriers and restrictions on imports and investments from abroad to protect domestic production.liberalization in such activities helped domestic firms to enter global market.

3. Development of services that support international business:

Any business in order to function and grow needs an ecosystem of suppliers, vendors, and infrastructure that supports the operations of the business. For instance, if a certain company wants to setup its operations in a particular place, it needs land, roads, water and power supply, and vendors and suppliers to supply its raw materials or other factors of production.

Development in such services that supports international trade helps in increasing globalization.

4. Growing consumer pressures:

Over the years customer's choices and preference have increased rapidly. Every customers needs wide range of products based on quality and price. It is manufacturer's responsibility to serve to customers and fulfill demands of their consumers. It is not possible to provide customers with their needs by operating in one country. Some demands can be fulfilled by entering in international market. That is how increasing consumer pressure helped in increased globalization.

5. Increased global competition:

Increased global competition and higher profit margin in business beyond boundaries attracts domestic manufacturer to enter in international business and be a part of group of higher profit making companies.

6. Changing political situations:

Every country has different political conditions. Nowadays political situation has changed and they supports international business activities which in return also helps to increase GNP of domestic country. Two countries having same political ideologies or aims can proved to be beneficial for domestic country to operate in another country having same political situation. And this can increase globalization.

7. Expanded cross-national co-operation:

Increased co-operation between countries can help domestic countries to operate in another countries. Co-operation can be in terms of ideology, pricing, marketing strategies, services etc.

● Why do firms expand internationally?

Going international is a strategy that is influenced by a variety of factors and is typically implemented over time.

In general, companies go international because they want to grow or expand operations. The benefits of entering international markets include generating more revenue, competing for new sales, investment opportunities, diversifying, reducing costs and recruiting new talent.

Following are some major motives/ reasons that helps to understand as to why do firms expand internationally.

(1) Market motives

(2) Economic motives

(3) Strategic motives

(1) Market motives

1.1 To expand their sales:

When businesses have exhausted growth opportunities at home, they turn to global expansion to help grow their business. For many companies, international expansion offers a chance to explore markets and gain access to millions of customers, thus increasing sales.

Even if company operators generally are satisfied with revenue levels, international expansion can further improve overall revenues. The race to expand internationally is often about gaining a presence in foreign markets. Being the first to arrive in a new market can provide significant advantages.

1.2 Seize market opportunities in foreign countries through trade or investment:

Keeping your business in the home market can limit potential for profit. One of the downsides companies face when they operate in only one country is the exposure to market changes. Taking your business international allows you the opportunity to diversify your markets, so your revenue is more stable. If your domestic market is slowing down, having the advantage of a global market will help cushion the company during slower economic times.

(2) Economic motives

2.1 For higher returns (profitability) through higher revenues and/or lower costs by obtaining cheap resources:

By setting up in a new country, a business will be able to lower their operational costs and save money. Many companies have found its advantageous to move some of their manufacturing operations to other markets due to cheaper labour costs and more affordable talent.

Improving profit margins is one of the most common reasons for entering international markets. When growth strategies are used up on the national level, the next path is often to seek out international growth. Distributing your products in additional countries increases your customer base. As you offer compelling solutions and build loyalty across international markets, revenue strengthens and escalates as well.

There are also significant cost savings that can be associated with going international. A company may want to reduce costs by relocating closer to a supplier or benefit from lower production costs by expanding operations to another country. Doing business internationally may open up new investment opportunities. Further, a lower cost of acquiring customers may be another compelling reason to expand internationally.

2.2 Achieving economies of scale:

Globalization– the integration of factors of production and inclusion of consumer groups from different markets around the world – facilitates unprecedented achievements of economies of scale for producers. Access to increased numbers of laborers, investors, markets, resources, technologies and business models through globalization can theoretically maximize productive efficiency to a level consistent with the size of the world's population.

2.3 Spreading R&D cost:

Successfully growing companies are often defined by two characteristics – they prioritize R&D investment and global expansion. The great enabler of global expansion is R&D.

Entering in an international market helps firms to spread or divide its R&D cost over a large market.

(3) Strategic motives

3.1 To capitalize on their distinctive resources or capabilities already developed at home:

One of the strategic motives to expand internationally is to take advantage of already established capabilities in domestic market. If in a domestic market a company is having distinctive resources or capabilities, company would surely wants to use these capabilities as weapon to enter the international market.

Such capabilities can be as follows:

- Technological leadership
- Brand image
- Customer loyalty
- Competitive position

3.2 To take first mover advantage:

A first-mover advantage can be simply defined as a firm's ability to be better off than its competitors as a result of being first to market in a new product category.

An advantage of being a first mover is that: there is an opportunity to increase sales volume ahead of rivals.

A firm will move to international market as a strategic decision to avail the benefits of first mover advantage.

3.3 Vertical integration involving different countries:

Vertical integration is a corporate strategy that involves growth through streamlining operations. This occurs when one company acquires a producer, vendor, supplier, distributor, or other related company within the same industry. Companies that choose to integrate vertically do so to strengthen their supply chains, reduce their production costs, capture upstream or downstream profits, or access new distribution channels.

Vertical integration involves the acquisition of business operations within the same production vertical.

Vertical integration can help boost profit and allow companies more immediate access to consumers.

3.4 To follow the major customer's abroad (proximity to customers):

One of the strategic motive to expand internationally can be to serve a potential customers of international market.

Through international expansion of business, a firm can fulfill demands of international customers with more proximity. This might be difficult with domestic business.

• EPRG Framework

A firm having a presence in the global market has to decide the manner in which it will enter and operate there. Firms in the international market have a different orientation and operating strategy. The country in which a company has it's headquartered is Home country and countries where it has subsidiaries are known as host countries.

EPRG Framework helps the company to decide the way in which strategic decisions are being made and how the company manages operations between headquarter and its subsidiaries. The concept of EPRG was introduced by Howard V. Perlmutter within the journal article "The Tortuous Evolution of Multinational Enterprises" in 1969.

1. ETHNOCENTRIC ORIENTATION (Home country orientation)

This approach is guided by **domestic market extension concept.**

In this approach, A firm employs home market strategies to the international market. Plans for overseas market are developed in the home office of the company. Personnel is hired from home country. Also, promotion and distribution strategies are similar to that employed in the home country.

In this approach, domestic strategies, techniques, and personnel are perceived as superior and International customers are considered as secondary.

The ethnocentric approach of the EPRG Framework has benefits but also downsides. At first, the company saves a lot of operational costs that can be invested elsewhere. But the downside is that the company does not build up new knowledge about the market abroad, which could substantially increase sales volume if products and strategies would be adopted to the needs of the host country.

2. POLYCENTRIC APPROACH (Host country orientation)

This approach is Guided by the **multi domestic market concept**.

In the polycentric approach of the EPRG Framework is the opposite of the ethnocentric approach. A company that utilizes this approach carefully consider different markets abroad to identify host countries that could potentially offer the most benefits.

It means that if a company has a local headquarter and a separate office overseas in a host country that manages the operations in that or more countries, the marketing strategies are locally created and implemented based on the local needs.

In this approach, marketing strategies are framed out as per the situation of the host country (the country where subsidiary is situated). Decisions can be altered as per the economic, political and cultural disparities in the country. This provides a firm to manage its operations independently, without much interference from its headquartered.

3. REGIOCENTRIC ORIENTATION

This approach is Guided by **the global marketing concept.**

In this orientation, world regions that share economic, political, and/or cultural traits are perceived as distinct markets.

In this approach, a firm treats a group of countries with similar characteristics as a single market and accordingly designs a marketing strategy. Countries like India, Pakistan and Bangladesh possess similar characteristic and can be served well with a single marketing strategy.

4. GEOCENTRIC APPROACH

This approach is guided by **the global marketing concept.**

This approach maintains a balance between home and host market. Marketing strategies are not influenced by the home or host country preferences. A firm tries to adopt globalized marketing, formulates an integrated marketing strategy for across the globe. this enables a firm to enjoy economies of scale.

- The EPRG Framework suggests that companies must decide which approach is most suitable for achieving successful results in countries abroad. For this reason, the EPRG Framework can be a useful tool to utilize if a company does not know yet how to manage business activities between companies in the local country and a host country. The EPRG Framework is additionally useful for making strategic decisions.

● Modes of operation in International Business

There are four most common modes of operation in International Business which are as follows:

(1) Trade mode

(2) Contractual entry mode

(3) Foreign investment

(4) Greenfield investment

❖ We will discuss this modes of operation in detail:

(1) Trade mode

1.1 Direct Export:

Direct exporting refers to the sale in the foreign market by the manufacturer himself. A manufacturer does not use any middlemen in the channel between the home country and overseas market. Following figure shows direct exporting channels.

1.2 Indirect Export:

Indirect exporting refers to the transfer of the selling responsibility to other organization by the manufacturer. In indirect exporting, the manufacturer utilizes the services of various types of independent marketing middlemen.

1.3 **Counter-trade:**

Counter-trade is a reciprocal form of international trade in which goods or services are exchanged for other goods or services rather than for hard currency. This type of international trade is more common in developing countries with limited foreign exchange or credit facilities.

FOR EXAMPLE, Iranian oil for Newzeland's lamb

(2) Contractual entry mode

2.1 Licensing:

Licensing is an arrangement by which a firm transfers its intangible property such as expertise, know-how, blueprints, technology, and manufacturing design for a specified period of time.

FOR EXAMPLE: Walt Disney granting McDonald a licence to co-brand its happy meals with a Disney trademark.

2.2 Franchising:

Franchising is a form of technical collaboration in which the franchisee makes use of IPRs like trademarks, copyrights, business know-how, managerial assistance for creating a product.

FOR EXAMPLE: Marriott International (USA), Dunkin' Donuts, Subway

2.3 Management contracts:

Management contract is an arrangement under which operational control of an expertise is vested by contract in a separate enterprise that performs the necessary managerial functions in return of a fee.

FOR EXAMPLE: Security contract

2.4 Turnkey projects:

In a turnkey project agreement, a firm agrees to construct an entire plant in a foreign country and make it fully equipped and turn the project over the purchaser when it is ready for operation for remuneration.

FOR EXAMPLE: Construction contract

(3) Foreign Investment

3.1 Foreign Portfolio Investment:

Foreign portfolio investment (FPI) refers to the purchase of securities and other financial assets by investors from another country. Examples of foreign portfolio investments include stocks, bonds, mutual funds, exchange traded funds, American depositary receipts (ADRs), and global depositary receipts (GDRs).

3.2 Foreign Direct Investment:

Foreign Direct Investment (FDI) involves establishing a direct business interest in a foreign country, such as buying or establishing a manufacturing business, building warehouses, or buying buildings.

Foreign direct investment tends to involve establishing more of a substantial, long-term interest in the economy of a foreign country.

3.3 Mergers & Acquisitions:

A merger is an agreement that unites two existing companies into one new company. There are several types of mergers and also several

reasons why companies complete mergers. Mergers and acquisitions are commonly done to expand a company's reach, expand into new segments, or gain market share. All of these are done to increase shareholder value.

FOR EXAMPLE: Maruti Suzuki

Maruti Udyog limited (Indian automobile co. based in New Delhi)

Suzuki motor corporation (japan based multinational company)

On july 12,2012 Maruti Suzuki India merged with Suzuki Powertain India Limited.

(4) Greenfield Investment:

A Greenfield investment is a type of FDI in which a parent company creates a subsidiary in a different country, building its operations from the ground up.

FOR EXAMPLE: in 2007, Mercedes Benz entered the Indian market by purchasing 100 acres of land in pune, for establishing its new manufacturing unit.

- **Differences between Domestic and International Business**

A domestic market, also referred to as an internal market or domestic trading, is the supply and demand of goods, services, and securities within a single country.

According to the American Business Association (AMA) "international Business is the multinational process."

(1) Area served:

In domestic business, area served is small, while International Business serves to a larger area.

(2) Business operations:

The area of operation of the domestic business is limited, which is the home country. On the other hand, the area of operation of an international business is vast, i.e. it serves many countries at the same time.

(3) Risk:

International Business consists of more amount of risk as compared to Domestic business.

(4) Nature of customers:

The nature of customers of a domestic business is more or less same. Unlike, international business wherein the nature of customers of every country it serves is different.

(5) Capital Requirement:

Domestic Business requires comparatively less capital investment as compared to international business.

(6) Languages & Culture:

Domestic business deals with only one country having same language and culture, while International Business deals with multiple countries having different languages and cultures.

(7) Role of politics:

In International Business role of politics holds a vital importance as compared to Domestic business.

(8) Financial Climate:

Domestic business deals in the currency of the country in which it operates. On the contrary, the international business deals in the multiple currencies.

(9) Knowledge Requirement:

In Domestic Business management knowledge is required, while in International Business specific management knowledge and competence is required.

(10) Product planning & Development:

The quality standards of products and services provided by a domestic business is relatively low. Conversely, the quality standards of international business are very high which are set according to global standards.

(11) Familiarity:

In Domestic business, firm will be familiar with the domestic market, while in International Business due to lack of familiarity with the market, firm needs to conduct a research to understand the dynamics of market well.

(12) Government Interference:

International Business is having more government interference as compared to Domestic business.

(13) Research:

In Domestic business basic research is required, while International Business demands a in-depth research of foreign markets.

MODULE 1

CHAPTER 2

CULTURAL ENVIRONMENT

- **Introduction**

Culture is considered a central concept in anthropology, encompassing the range of phenomena that are transmitted through social learning in human societies. Cultural universals are found in all human societies. These include expressive forms like art, music, dance, ritual, religion, and technologies like tool usage, cooking, shelter, and clothing. The concept of material culture covers the physical expressions of culture, such as technology, architecture and art, whereas the immaterial aspects of culture such as principles of social organization (including practices of political organization and social institutions), mythology, philosophy, literature (both written and oral), and science comprise the intangible cultural heritage of a society.

- **Meaning of Culture**

Culture represents the entire set of social norms and behaviour of people living in a particular geographic boundary.

Culture refers to learned norms based on the values, attitudes, and beliefs of a group of people.

- **Cultural Environment**

The Socio-cultural fabric is an important environmental factor that should be analyzed while formulating business strategies. The cost of ignoring the customs, traditions, tastes and preferences, etc., of people could be very high.

The buying and consumption habits of the people, their language, beliefs and values, customs and traditions, tastes and preferences, education are all factors that affect business.

- **Elements of Culture**

Following are the elements or components of culture:

✓ Language
✓ Religion
✓ Education
✓ Values and beliefs
✓ Customs
✓ Aesthetics
✓ Social institutions
✓ Material elements

● How Culture forms and change

In a person's life, formation of culture happens at very early stage in life i.e. childhood. This formation in terms of habits, values, interests, attitudes can be derived from parents, family, friends, environment etc.

Humans acquire culture through the learning processes of enculturation and socialization, which is shown by the diversity of cultures across societies.

Cultures are externally affected via contact between societies, which may also produce—or inhibit—social shifts and changes in cultural practices.

Change in culture occurs in two ways:

By choice

By imposition

- **<u>Cultural Awareness</u>**

Cultural awareness is sensitivity to the similarities and differences that exist between two different cultures and the use of this sensitivity in effective communication with members of another cultural group.

- ✓ There is no foolproof way to build your awareness of culture
- ✓ Hard to isolate culture from economic and political conditions
- ✓ Education about a culture helps
- ✓ Studies of cultures have shortcomings

● The people factor

✓ Cultural diversity:

Cultural diversity is the quality of diverse or different cultures, as opposed to monoculture, the global monoculture, or a homogenization of cultures, akin to cultural evolution. The term cultural diversity can also refer to having different cultures respect each other's differences.

Moreover, it is often used to mention the variety of human societies or cultures in a specific region, or in the world as a whole. It refers to the inclusion of different cultural perspectives in an organization or society.`

✓ Cultural impact:

The term "cultural impact" refers to the consequences to human populations of any public or private policies and actions that significantly change their norms, values, beliefs, practices, institutions as well as the way they live, work, socialize and organize themselves as part of their cultural life.

Our culture shapes the way we work and play, and it makes a difference in how we view ourselves and others. It affects our values—what we consider right and wrong. This is how the society we live in influences our choices. But our choices can also influence others and ultimately help shape our society.

● **The Nation as a point of reference**

National culture is the shared values and assumptions held by individuals within the nation.

National culture is the norms, behaviors, beliefs, customs, and values shared by the population of a sovereign nation (e.g., a Chinese or Canadian national culture). It refers to specific characteristics such as language, religion, ethnic and racial identity, cultural history and traditions.

- ✓ Not everyone in a country shares the same culture.
- ✓ Certain cultural attributes may link groups from different nations more closely than certain groups within nations.

- **Language as a cultural stabilizer**

Language is one of the most important parts of any culture. It is the way by which people communicate with one another, build relationships, and create a sense of community.

Language isn't just a way to communicate, it's a component of culture that makes it unique and specific. When language and culture are discussed, the phrase "language is culture and culture is language" is often mentioned because the two are always intertwined. This means that the language you speak reflects what your values and beliefs are.

Language acts both as a diffuser of culture and as a stabilizer. On one hand, a common language unifies a culture.

- ✓ When people from different areas speak the same language, culture spreads more easily.
- ✓ Among nations that share a same language, commerce is easier.
- ✓ Isolation from other groups, especially because of language, tends to stabilize cultures.
- ✓ Some countries see language as being so important that they regulate the inclusion of foreign words and/or mandate the use of the country's official language for business purposes.

- **Religion as a cultural stabilizer**

Religion influences cultures, but it is also influenced by culture. Religion can play a big part in the cultural identity of people, influencing how they dress, what and when they eat, and how they behave.

Many of the cultural traditions are closely associated with religion, and many religious practices and behaviors have become so rooted in the daily lives of people all over the world that it is hard to make a distinct difference between culture and religion.

- ✓ Centuries of profound religious influence continue to play a major role in shaping cultural values.
- ✓ Many religions influence specific beliefs that may affect business.

● Factors affecting Risk taking behaviour

Risk taking is any consciously or non-consciously controlled behavior with a perceived uncertainty about its outcome, and/or about its possible benefits or costs for the physical, economic or psycho-social well-being of oneself or others.

Risk taking behaviour shows at which extent a person is ready to take risk.

❖ Following are some factors that affect a risk taking behaviour of a person:

(1) Uncertainty avoidance:

The uncertainty avoidance dimension relates to the degree to which individuals of a specific society are comfortable with uncertainty and the unknown. Countries displaying strong uncertainty avoidance index (UAI) believe and behave in a strict manner. Individuals belonging to those countries also avoid unconventional ways of thinking and behaving. Weak UAI societies display more ease in regards to uncertainty.

People in cultures with high uncertainty avoidance try to minimize the occurrence of unknown and unusual circumstances and to proceed with careful changes step by step by planning and by implementing rules, laws and regulations. In contrast, low uncertainty avoidance cultures accept and feel comfortable in unstructured situations or changeable environments and try to have as few rules as possible. People in these cultures tend to be more pragmatic and more tolerant of change.

(2) Trust:

Trust and risk have often been linked in the literature, but their relationship is far from clear. Trust has been used in three different ways — namely, as a perception ("subjective trust"), as various personal and situational factors that lead to subjective trust ("trust antecedents"), and as the actions resulting from subjective trust ("behavioral trust").

Behavioral trust can be viewed as risk taking.

(3) Future orientation:

Future orientation is broadly defined as the extent to which an individual thinks about the future, anticipates future consequences, and plans ahead before acting.

(4) Fatalism:

Fatalism can more generally be defined as the propensity of individuals or groups to believe that their destinies are ruled by an unseen power or are played out inevitably rather than by their will. The concept of fatalism has been closely intertwined to the development of religious and philosophical thought.

● Factors affecting the communication process

The relationship between communication and culture is a very complex. Cultures are created through communication; communication is the means of human interaction through which cultural characteristics— whether customs, roles, rules, rituals, laws, or other patterns—are created and shared.

Without communication and communication media, it would be impossible to preserve and pass along cultural characteristics from one place and time to another. One can say, therefore, that culture is created, shaped, transmitted, and learned through communication. The reverse is also the case; that is, communication practices are largely created, shaped, and transmitted by culture.

❖ Following are some factors that affects the communication process:

(1) Spoken and written language:

For so long, people have treated words as mere labels for objects, and languages as different ways to string words together to convey thoughts, feelings, and concepts. But language is more than that. Because of it, we can exchange complex thoughts and ideas with one another, whether it be spoken aloud or written in ink. It's also through language that we're able to trigger emotions, imagination, and action.

(2) Silent Language:

Silent language is nonverbal communication such as body language, gestures, appearance, and the modes of greeting. All of these changes around the world and international business people have to be aware of these differences.

2.1 Colour association:

Colors carry deep meanings with them in every culture. Western, Far Eastern, Middle Eastern, Indian, and African cultures have stark differences in the symbolism of colors within their cultures.

For instance, in some cultures, white represents innocence, but in others, it can represent death.

2.2 Conversational Distance:

Conversational distance (the space one needs to feel comfortable when talking to another person) varies widely from culture to culture and from circumstance to circumstance.

Most people find that they need more personal space when speaking with strangers than they do with close friends or family members.

2.3 Perception of time and punctuality:

Different understandings of time come to attention when people from different cultural backgrounds come to have a formal meeting together. Cultures that measure time by the clock will expect all participants to be punctual, whereas event-time cultures wouldn’t be so strict.

2.4 Body language and Gestures:

Gestures are used in every language around the world for joy, despair, triumph, anger, and other emotions. Even though everyone uses gestures, they don’t mean the same thing in different countries. You can seriously offend someone if you accidentally make an offensive gesture.

● Dealing with cultural differences:

Cultural difference involves the integrated and maintained system of socially acquired values, beliefs, and rules of conduct which impact the range of accepted behaviors distinguishable from one societal group to another.

❖ Following are the ways to deal with cultural diversity:

(1) Accommodation:

Cultural accommodation refers to the process by which individuals may take on values and beliefs of the host culture and accommodate them in the public sphere, while maintaining the parent culture in the private sphere.

Accommodating to culture suggests an adjustment or adaptation to a culture or a set of cultural beliefs, practices, or traditions.

(2) Understand cultural difference:

Understanding different cultures allows you to be more open, accepting, and tolerant of other people. Understanding different cultures is more than having an appreciation for our differences, but paving the way for a new world where we all stand together.

(3) Help to overcome cultural shock:

Culture shock refers to feelings of uncertainty, confusion, or anxiety that people may experience when moving to a new country or experiencing a new culture or surroundings.

Over time, people can become familiar with their new surroundings as they make new friends and learn the customs, leading to an appreciation of the culture.

MODULE 1

CHAPTER 3

POLITICAL ENVIRONMENT

Introduction

The political environment in international business consists of a set of political factors and government activities in a foreign market that can either facilitate or hinder a business' ability to conduct business activities in the foreign market.

The political environment of the country of operation becomes increasingly important for an internationalizing firm as it moves from exports to foreign direct investment (FDI) as the mode of international market entry.

The political factors usually go hand in hand with the legal ones and are generally viewed as the non-market forces that impact businesses.

Political System

A political system is a system that necessarily has two properties: a set of interdependent components and boundaries toward the environment with which it interacts.

A political system is a concept in which theoretically regarded as a way of the government makes a policy and also to make them more organized in their administration.

A political system is one that ensures the maintaining of order and rationality in the society and at the same time makes it possible for some other institutions to also have their grievances and complaints put across in the course of social existence.

It is the complete set of institutions, political organizations, and interest groups.

The relationships among institutions, and the political norms and rules that govern their functions.

- **Individualism v/s Collectivism**

❖ **Individualism:**

Primacy (command) of the rights and role of the individual.

❖ **Collectivism:**

Primacy (command) of the rights and role of the community.

Both collectivism and individualism are principles, practices, political theories, and cultural patterns. They are often viewed as being in contrast with each other.

Collectivism prioritizes group cohesion over individual pursuits, and it sees long-term relationships as essential since it promotes group goals.

Collectivism is also a political theory which is related with communism since it proposes that power should be placed in the hands of the citizens as a whole instead of in the hands of only several individuals such as those in the upper class. Hence, it is beneficial to construct a system which facilitates shared goals.

On the other hand, individualism focuses on human independence

and freedom. It is generally against external interference regarding personal choices.

individualism is associated with liberalism which places importance on individual freedom which was recognized specially since the Enlightenment. It is also related with autarchism which rejects compulsory government and promotes self-reliance and individual freedom.

• Political Ideology

It is the system of ideas that expresses the goals, theories, and aims of a sociopolitical program.

A political ideology is a certain set of ethical ideas, principles, doctrines, myths or symbols of a social movement, institution, class or large group that explains how society should work and offers some political and cultural blueprint for a certain social order.

Most modern societies are pluralistic—different groups champion competing political ideologies.

• Political Risk

Political risk is a risk that political decisions or events in a country negatively affect the profitability or sustainability of an investment.

Political risk is the possibility that your business could suffer because of instability or political changes in a country: conflicts and unrest, changes in regime or government, changes in international policies or relations between countries, as well as changes that occur in a country's policies, business laws or investment regulations.

● Types of Political Risk

❖ In 1999, Czinkota classified political risk as following:

(1) Ownership risk:

When operations of international businesses are at risk due to threatening of government expropriation or takeover, which may result for the company to lose their offshore property. This may be said as nationalization of business and protectionism.

(2) Operation risk:

The government policies of the host country may act as an obstacles for the progress of international businesses in their operations such as marketing ,finance or property. These policies are known as operational risk.

(3) Transfer risk:

Performance of the currency exchange rates depends on the government policy. Company's strength to transfer capital out of host country may be affected because of resultant of government policy in currency devaluation or economic downtime. If a company is creating a wealth in other country then it may be forced by host country government to return a considerable amount, which is known as repatriation of earnings.

❖ In 1982, Stephen Kobrin classified political risk as following:

(1) **Macro risk:**

It is also known as country specific risk

Macro risk is a type of political risk companies face when conducting operations in foreign countries. Macro risk refers to adverse actions that will affect all foreign firms. This type of risk affects all international businesses in the same way.

✓ **Examples of Macro risk:**

1.1 Expropriation:

Expropriation is the act of a government claiming privately owned property to be used for the benefit of the overall public.

Properties may be expropriated in order to build highways, railroads, airports, or other infrastructure projects.

Property owners must be compensated fairly for property that is expropriated, as instructed by the Fifth Amendment.

1.2 Currency Inconvertibility:

A type of political risk in which a governmental regulation limits or prevents a company from making payments in foreign currency or from converting local currency into foreign currency.

1.3 Credit risk:

Credit risk is the possibility of a loss resulting from a borrower's failure to repay a loan or meet contractual obligations. Traditionally, it refers to the risk that a lender may not receive the owed principal and interest, which results in an interruption of cash flows and increased costs for collection.

1.4 Risk from ethnic, religious or civil strife:

An **ethnic conflict** is a conflict between two or more contending ethnic groups. While the source of the conflict may be political, social, economic or religious, the individuals in conflict must expressly fight for their ethnic group's position within society.

A **religious war** or holy war is a war primarily caused or justified by differences in religion.

Civil strife is a war between political factions or religions within the same country.

1.5 Conflict of interest:

Government decisions should be guided by public interest, that is, what is believed to be most beneficial to the general welfare of society. A conflict of interest arises when the private interests of a politician or official clash or coincide with that public interest.

● Managing political risk

❖ Managing prior to investment:

(1) Capital budgeting:

Capital budgeting is the process a business undertakes to evaluate potential major projects or investments.

Capital budgeting is important because it creates accountability and measurability. The capital budgeting process is a measurable way for businesses to determine the long-term economic and financial profitability of any investment project.

(2) Reducing the investment flow and fill the gap through local borrowing:

Instead of investing with sole accountability, a firm should reduce the investment flow to reduce a risk and the gap should be filled by local borrowings to share the risk with local investors.

The risk can be reduced through reducing the investment flow from the parent to the subsidiary and filling the gap through local borrowing in the host country. In this strategy, it is possible that the firm may not get the cheapest fund, but the risk will be reduced. The

firm will have to make a trade-off between higher financing cost and lower political risk.

(3) Agreement with host government:

An agreement between a foreign investor and a local or host government governing the rights and obligations of the foreign investor and the host government with respect to the development, construction, and operation of a project by the foreign investor is known as Host Government Agreement.

Many HGAs include a stabilization clause designed to minimize the financial and political risks posed to foreign investors as a result of sudden changes in national law.

(4) Planned divestment:

If the company plans an orderly shifting of ownership and control of business to the local shareholders and it implements the plan, the risk of expropriation will be minimal.

(5) Insurance of Risk:

The major international risks for businesses include foreign exchange and political risks.

Foreign exchange risk is the risk of currency value fluctuations, usually related to an appreciation of the domestic currency relative to a foreign currency.

Political risk happens when countries change policies that might negatively affect a business, such as trade barriers.

Insurance acts as a compensating mechanism of loss and risk transference. Hence, the risk transfer is one of the main functions of insurance.

❖ Management during the lifetime of project:

(1) Concession agreement:

A concession agreement is a contract that gives a company the right to operate a specific business within a government's jurisdiction or on another firm's property, subject to particular terms.

A concession or concession agreement is a grant of rights, land or property by a government, local authority, corporation, individual or other legal entity.

(2) Political support:

Risk can also be managed with political support. International companies sometimes act as a medium through which the host government fulfills its political needs.

As long as political support is provided by the home country government, the assets of the company are safe. However such a relationship may change and the political alliance may be disturbed when a new government is formed.

(3) Structured operating environment:

Political risk can be reduced by creating a linkage of dependency between the operation of firm in high risk country and the operation of other units of the same firm in other countries.

If the unit in a high risk country is dependent on its sister units in other countries for the supply of technology or raw material or for marketing of its products, the former is normally not nationalized so long as dependency is maintained.

It is because the high risk unit will not be in a position to operate without the imported technology or raw material.

(4) Anticipatory planning:

Anticipatory planning is also useful tool in risk management. It is a fact that the investing company takes necessary precautions against the political risk prior to the investment or after the investment. But it is of utmost significance that it should plan the measures to be taken quite in advance.

❖ Management following Nationalization:

(1) Negotiation:

The investing company negotiates with the host government on various issues and shows its willingness to support the policy and programme of the latter.

(2) Political and economic pressures:

On failure of negotiation with the host government, the investing company tries to put political and economic pressure. Embargo on trade is one of the examples.

But there are occasions when such pressures deepen the rift. Thus, firms should be cautious before taking such measures.

(3) Arbitration:

It involves the help of a neutral third party who mediates and asks for the payment of compensation. But there are cases when the host government does not honour the verdict of the arbitrator.

(4) Approach the court of law:

The international law suggests that the company has, first of all, to seek justice in the host country itself. If it is not satisfied with the judgement of the court, the company can go to the international court of justice for fixation of adequate compensation.

MODULE 1

CHAPTER 4

LEGAL ENVIRONMENT

Introduction

The global legal environment refers to the legal environment in international business. The legal environment regulates the operations of firms in international markets.

Governments impose laws to protect the home industry from cut- throat global competition.

Legal system

The mechanism for creating, interpreting, and enforcing the laws in a specified jurisdiction

A country's legal system which embraces its law and regulation, is closely related to its political system.

- **Types of legal system**

(1) Common law:

Common law is a law based largely on interpretation, tradition and precedence.

Common law is based upon tradition, precedence, custom, and usage; therefore, courts play an important role in interpreting the law.

Common-law nations include Australia, Canada, New Zealand, United States and some parts of Asia and Africa.

(2) Civil law:

Civil law is a system of law where rules and regulations are written in detail.

Civil law deals with cases where wrong is done against a particular individual.

Civil law is based upon a detailed set of laws that comprise a code that includes rules for conducting business; therefore, courts play an important role in applying the law.

Civil law nations include France, Germany, and Japan.

(3) Theocratic law :

Theocratic law is based upon religious precepts; ultimate legal authority is conferred upon religious leaders who govern society. The best example is Islamic law, or Shari'a, which is based on the Koran, the Sunnah, the writings of Islamic scholars, and the consensus of Muslim countries' legal communities.

(4) Customary law :

Customary law is a law that captures the norms, and rules of behaviour of the people.

It is the law propelled by the beliefs, philosophies and value system of the people.

Customary law may play a significant role in matters of personal conduct in countries with mixed legal systems.

(5) Mixed systems :

A mixed legal system emerges when two or more legal systems are used within a single country. Although the majority of such countries are found in Africa and Asia, the United States' legal system combines both common and civil law.

● Legal issues in International Business

❖ Operational considerations

(1) Starting a business:

While entering in an international business, a firm has to consider legal aspects related to establishing a firm.

Following legal aspects affects the establishment of company:

- ✓ Licence
- ✓ Intellectual Property Rights

(2) Entering and enforcing contract:

A contract is enforceable if a court is willing to obligate both parties to carry out the terms of the agreement. Courts deem contracts enforceable if the terms are willingly agreed to by the parties and something of value is exchanged between the parties. Contracts must not violate public policy.

(3) Hiring and firing local workers:

Before hiring any employees, you may need to draft an employment contract. An employment contract can cover such issues as specific job duties, periodic pay increases, overtime, and your expectations for your employees' behavior while on the job.

If you have set forth specific expectations for your employees, you can avoid potential lawsuits and unemployment claims if you can document an employee's failure to perform, or if your employment contract clearly states the circumstances under which an employee may be fired.

(4) Closing down the business:

Closing your business can be a difficult and challenging task. A firm need to consider following steps while closing a business.

- ✓ File a final return and related forms
- ✓ Take care of your employees

  (employment taxes and pension or benefit plans)

- ✓ Pay the tax you owe
- ✓ Payment to contract workers
- ✓ Cancel your Employer Identification number (EIN)
- ✓ Keep your records

❖ Strategic considerations:

(1) Product safety and liability:

If your business faces product liability issues, things can result in a lawsuit that could cost you a lot. Product liability claims can end up with damages to consumers worth millions of dollars. Such cases happen because often, product liability cases cause severe health damages and may lead to death.

(2) Marketplace behaviour:

Market behavior is a broad economic term that refers to the behavior of consumers, businesses, or the stock market. It is often analyzed and used to generate various marketing strategies aimed at boosting sales or brand recognition when dealing with businesses and consumers by analyzing their purchasing behavior.

(3) Product origin:

Rules of origin are used to make more precise any aspect of trade law or trade policy that treats goods differently depending upon their country of origin. ... For example, quotas, countervailing duties, and anti-dumping measures restrict goods imported from specific producing countries.

(4) Legal jurisdiction:

Jurisdiction refers to the power of a state to affect persons, property, and circumstances within its territory. It may be exercised through legislative, executive, or judicial actions. International law particularly addresses questions of criminal law and essentially leaves civil jurisdiction to national control.

(5) Arbitration:

International commercial arbitration is a means of resolving disputes arising under international commercial contracts. It is used as an alternative to litigation and is controlled primarily by the terms previously agreed upon by the contracting parties, rather than by national legislation or procedural rules.

MODULE 1

CHAPTER 5

ECONOMIC ENVIRONMENT

- **Economic system:**

A mechanism that deals with the production, distribution, and consumption of goods and services.

An Economic system is a means by which societies or governments organize and distribute available resources, services, and goods across a geographic region or country.

- **<u>Types of economic system:</u>**

(1) Centrally Planned Economy:

CPE is an economic system in which a Central authority such as government, makes economic decisions regarding manufacturing and distribution of products.

Also known as Command Economy or a Planned Economy.

EXAMPLE: China, Former Soviet Union

(2) Market Based Economy:

In the Market based economic system, the decision to produce and distribute goods is taken by individual firms based on the forces of Demand and Supply.

EXAMPLE: United States, England and Japan

(3) Mixed Economy:

Mixed economy represents mixture of state control on one hand and the economic freedom of entrepreneurs and consumers on the other hand.

EXAMPLE: India

Elements of Economic environment

(1) GDP:

Gross domestic product (GDP) is the standard measure of the value added created through the production of goods and services in a country during a certain period. As such, it also measures the income earned from that production, or the total amount spent on final goods and services (less imports).

(2) GNP:

Gross national product (GNP), total market value of the final goods and services produced by a nation's economy during a specific period of time (usually a year), computed before allowance is made for the depreciation or consumption of capital used in the process of production.

- ✓ **GNP = C + I + G + X + Z**

Where C is Consumption, I is investment, G is government, X is net exports, and Z is net income earned by domestic residents from overseas investments minus net income earned by foreign residents from domestic investments.

- **Economic analysis**

Economic analysis is study of the Economic system.

The analysis aims to determine how effectively the economy is operating.

- **Economic indicators**

Whenever a firm moves abroad for International Business, it takes into account some preliminary economic indicators of the host country which are as follows:

(1) Inflation:

The size of demand for a product depends not only on the level of income and its distribution, but it also subject to the level of the inflation in the country.

Because purchasing power of the consumers depends on their real income.Higher the level of inflation, lower the real income and lower the purchasing power of the consumers.

Thus, when a multinational firm decides to set up a manufacturing unit in a foreign country, it has to take into account the rate of inflation in the host country.

(2) Unemployment:

The unemployment rate is a useful measure of the under-utilization of the labour supply. It reflects the inability of an economy to generate employment for those persons who want to work but are not doing so, even though they are available for employment and actively seeking work. It is thus seen as an indicator of the efficiency and effectiveness of an economy to absorb its labour force and of the performance of the labour market.

Unemployment Rate = persons unemployed / labour force * 100

(3) Debt:

Debt is a sum of money borrowed by one entity, namely the borrower from another entity, namely the lenders. Governments raise debts to cover their deficit finances which help pay for ongoing activities as well as major capital projects. This debt may be issued in the form of loans or by issuing bonds.

The national debt level of the country is measurement of how much the government owes its creditors.

Some worry that excessive government debt levels can impact economic stability.

(4) Income distribution:

The size of demand for a product is dependent upon the size of income of its buyer.

The level of income is normally represented by the GDP, GNP and NNP.

Income level in a country with larger population should better be calculated with Per Capita Income.

(5) Poverty:

Poverty rates are related to the overall health of the economy. As the economy grows, so do opportunities for employment and income growth. That is, lower poverty rates coincide with decreases in unemployment or increases in income.

Higher minority populations are associated with higher poverty rates.

Higher median age population is associated with lower poverty rates.

- **Balance of trade**

Balance of trade is a statement which records a country's imports and exports of goods with other countries in a specified period of time.

BOT = country's Exports - country's Imports

If BOT is positive, there is Trade Surplus

If BOT is negative, there is Trade Deficit

- **Balance of payment**

Balance of payment is a statement that records all the economic transactions performed by that country within a specified period of time.

BOP = Current account + Financial account + Capital account

MBA SEMESTER 3

INTERNATIONAL BUSINESS

(4539281)

MODULE 2

CHAPTER 1

INTERNATIONAL TRADE THEORIES

Introduction

International trade theories are simply different theories to explain international trade. Trade is the concept of exchanging goods and services between two people or entities. International trade is the concept of this exchange between people or entities in two different countries.

The aim of Trade Theory is to explain the existing patterns of trade, the impact on the domestic economy, and the type of public policies that should be introduced to increase a country's well-being.

People or entities trade because they believe that they benefit from the exchange. They may need or want the goods or services. While at the surface, this many sound very simple, there is a great deal of theory, policy, and business strategy that constitutes international trade.

In this section, you'll learn about the different trade theories that have evolved over the past century and which are most relevant today.

INTERNATIONAL TRADE THEORIES

Classical Country-Based Theories	Modern Firm-Based Theories
Mercantilism	Country Similarity
Absolute Advantage	Product Life Cycle
Comparative Advantage	Global strategic Rivalry
Heckscher-Ohlin	Porter's National Competitive Advantage

❖ Classical trade theories

Over time, economists have developed theories to explain the mechanisms of global trade.

The main historical theories are called classical and are from the perspective of a country, or we can say these theories are country-based theories.

(1) Theory of Mercantilism

Developed in the sixteenth century, mercantilism was one of the earliest efforts to develop an economic theory.

This theory stated that a country's wealth was determined by the amount of its gold and silver holdings. In it's simplest sense, mercantilists believed that a country should increase its holdings of gold and silver by promoting exports and discouraging imports.

Mercantilism advocates government regulation of international trade to generate wealth and strengthen national power. Merchants and the government work together to reduce the trade deficit and create a surplus.

In other words, if people in other countries buy more from you (exports) than they sell to you (imports), then they have to pay you the difference in gold and silver.

Mercantilism also worked hand-in-hand with the gold standard. Countries paid each other in gold for exports. The nations with the most gold were the richest. They could hire mercenaries and explorers to expand their empires. They also funded wars against other nations who wanted to exploit them.

As a result, all countries wanted a trade surplus rather than a deficit.

The objective of each country was to have a trade surplus and to avoid a trade deficit.

- You can have trade surplus if you

  Maximize export through subsidies.

  Minimize imports through tariffs and quotas

✧ Neo-mercantilism theory

Neo-mercantilism policy also seeks a favorable balance of trade, but its purpose is to achieve some social or political objective.

A revived theory of mercantilism emphasizing trade restrictions and commercial policies as means of increasing domestic income and employment.

Adam Smith argued against mercantilism with his 1776 publication of "The Wealth of Nations." He argued that foreign trade strengthens the economies of both countries. Each country specializes in what it produces best, giving it a comparative advantage. He also explained that a government that put business ahead of its people would not last.

(2) Absolute advantage theory

In 1776, Adam Smith questioned the leading mercantile theory of the time in 'An Enquiry into the Nature and Causes of the Wealth of Nations'. He was the father of Modern Economics. He presented this theory which came out as a strong reaction against the mercantilist views on international trade.

Adam's theory specified that a country's prosperity should not be premeditated by how much gold and other precious metals it has, but rather by the living standards of its citizens.

Smith reasoned that trade between countries shouldn't be regulated or restricted by government policy or intervention. He stated that trade should flow naturally according to market forces.

Smith offered a new trade theory called absolute advantage, which focused on the ability of a country to produce a good more efficiently than another nation.

Adam Smith supported the necessity of free trade as the only assurance for expansion of trade. He said that a country should only produce those products in which they have an absolute advantage.

According to Smith, free trade promoted international division of labour. By specialization and division of labour producers with different absolute advantages can always gain over producing in remoteness. He emphasized on producing what a country specializes in so that it can produce more at a lower cost than other countries. This theory says that a country should export a product in which it has a cost advantage.

When one country can produce a unit of good with less cost than another country, the first country has an absolute (cost) advantage in producing that good.

✧ **Assumptions:**

- ✓ Labour is the only factor of production and its productivity remains the same.
- ✓ Perfect mobility of labour between the sectors within a country.
- ✓ No mobility of labour between the countries.
- ✓ Assumes perfect competition
- ✓ No transportation cost
- ✓ No restrictions on the movement of goods between the countries (free trade)

✧ Example:

Assume, two countries, country A and country B Producing only two commodities, x and y.

Suppose, A can produce x cheaper than B, and B can produce y cheaper than A.

Means, A has an absolute advantage in the production of x and B in the production of y.

A will export x to B, and B will export y to A

✧ Summary:

Both countries will gain from the trade

Results in specialization

Increases productivity

But what happens if A has absolute advantage in the production of both x and y?

i.e., if A can produce x cheaper than B and it can produce y much cheaper than B

Should A produce both x and y and B nothing?

- To answer this question 'comparative advantage theory' was formed.

(3) Comparative advantage theory

This theory was given by David Ricardo, in the book 'The Principles of Political Economy & Taxation' in 1817.

In this theory, David said that absolute advantage is not necessary. Nations can still gain from trade even without an absolute advantage.

Comparative advantage is an economy's ability to produce a particular good or service at a lower opportunity cost than its trading partners. Comparative advantage is used to explain why companies, countries, or individuals can benefit from trade.

A country has a Comparative Advantage in producing a good if the opportunity cost of producing that good in terms of other goods is lower in that country compared to other countries.

✧ **Example:**

The US can produce 20 planes or 2 cruise ships.

France can produce 12 planes or 2 cruise ships.

	PLANES	**CRUISE SHIP**
US	20 (1p costs 1/10 c)	2 (1 c costs 10 p)
FRANCE	12 (1 p costs 1/6 c)	2 (1 c costs 6 p)

US has a comparative advantage in producing planes.

France has a comparative advantage in producing cruise.

France can export 1 cruise in exchange of how many planes?

(4) Factor mobility theory

The theories of Smith and Ricardo didn't help countries determine which products would give a country an advantage.

In the early 1900s, two Swedish economists, Eli Heckscher and Bertil Ohlin, focused their attention on how a country could gain comparative advantage by producing products that utilized factors that were in abundance in the country.

Their theory is based on a country's production factors:

-land, labor, and capital.

Factors that were in great supply relative to demand would be cheaper; factors in great demand relative to supply would be more expensive.

This theory stated that countries would produce and export goods that required resources or factors that were in great supply and, therefore, cheaper production factors.

In contrast, countries would import goods that required resources that were in short supply, but higher demand.

In contrast to classical, country-based trade theories, the category of modern, firm-based theories emerged after World War II.

Unlike the country-based theories, firm-based theories incorporate other product and service factors, including brand and customer loyalty, technology, and quality, into the understanding of trade flows.

❖ Modern trade theories

In contrast to classical, country-based trade theories, the category of modern, firm-based theories emerged after World War II.

Unlike the country-based theories, firm-based theories incorporate other product and service factors, including brand and customer loyalty, technology, and quality, into the understanding of trade flows.

(1) Product Life Cycle Theory

Raymond Vernon, a Harvard Business School professor, developed the product life cycle theory in the 1960s.

The Product Life Cycle Theory is an economic theory that was developed by Raymond Vernon in response to the failure of the Heckscher-Ohlin model to explain the observed pattern of international trade.

The theory suggests that early in a product's life-cycle all the parts and labor associated with that product come from the area where it was invented. After the product becomes adopted and used in the world markets, production gradually moves away from the point of origin.

Raymond Vernon divided products into three categories based on their stage in the product life cycle and how they behave in the international trade market:

- New Product
- Maturing Product
- Standardized Product

✓ In the new product stage, the product is produced and consumed; no export trade occurs.

✓ In the maturing product stage, mass-production techniques are developed and foreign demand (in developed countries) expands.

✓ In the standardized product stage, production moves to developing countries.

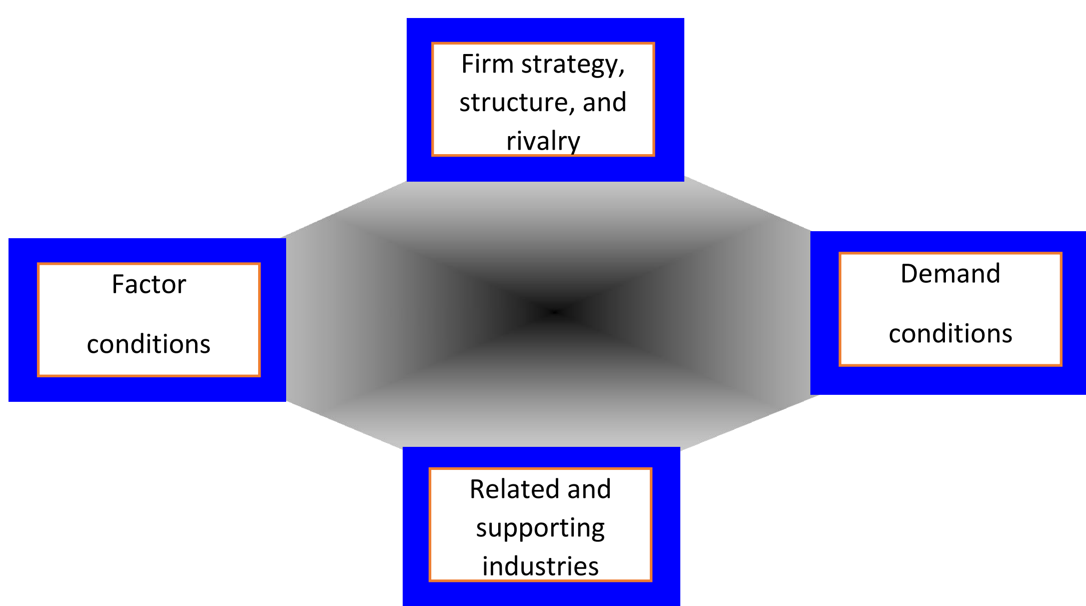
(2) Porter's Diamond theory of national advantage

In the continuing evolution of international trade theories, Michael Porter of Harvard Business School developed a new model to explain national competitive advantage in 1990.

Porter's theory stated that a nation's competitiveness in an industry depends on the capacity of the industry to innovate and upgrade.

His theory focused on explaining why some nations are more competitive in certain industries.

❖ To explain his theory, Porter identified four determinants that he linked together.



➢ Factor Conditions

Porter added to these basic factors a new list of advanced factors, which he defined as skilled labor, investments in education, technology, and infrastructure.

He perceived these advanced factors as providing a country with a sustainable competitive advantage.

➢ Demand Conditions

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

Companies whose domestic markets are sophisticated, trendsetting, and demanding; forces continuous innovation and the development of new products and technologies.

➢ Related and supporting industries

To remain competitive, large firms benefit from having strong, efficient supporting and related industries to provide the inputs required by the industry.

Certain industries cluster geographically, which provides efficiencies and productivity.

✧ Advantages of such clustering:

- Potential technology knowledge

✧ Disadvantages:

- Potential poaching (illegal hunt) of your employees by rival companies

❖ Firm strategy, structure and rivalry

➢ Strategy:

Local strategy affects a firm's competitiveness.

Eg. Investment plans, use of labour force

➢ Structure:

The industry structure has five components, competitors, potential competitors, substitute products, and suppliers. Each plays a role in determining the intensity of competition in explaining why some industries are historically more profitable than others.

➢ Rivalry:

A healthy level of rivalry between local firms will spur innovation and competitiveness.

(3) Country similarity theory

Swedish economist Steffan Linder developed the country similarity theory in 1961, as he tried to explain the concept of intra-industry trade.

Linder's theory proposed that consumers in countries that are in the same or similar stage of development would have similar preferences.

According this theory, the companies that develop new products for the domestic market, export the products to those countries that are at similar level of development after meeting the needs of the domestic market.

Linder's country similarity theory then states that most trade in manufactured goods will be between countries with similar per capita incomes, and intraindustry trade will be common.

❖ Basis for trade among countries:

- Similarity of location
- Cultural similarity
- Similarity of political and economic interests

(4) Global strategic rivalry theory

Global strategic rivalry theory emerged in the 1980s and was based on the work of economists Paul Krugman and Kelvin Lancaster.

Their theory focused on MNCs and their efforts to gain a competitive advantage against other global firms in their industry.

Firms will encounter global competition in their industries and in order to prosper, they must develop competitive advantages.

❖ **How a firm can gain competitive advantage**

(1) Owning intellectual property:

It is done by registering a brand name, trademark, patent/copy right, unique formula etc.

Example - Unique formula of Coca-cola

(2) Investing in R&D:

It is the process of gaining competitive advantage by R&D techniques.

Example - Boeing is the most successful airplane industry because it does huge amount of research for its competitors by its R&D department.

(3) Achieving economies of scale:

It is a process where cost advantages can be reaped by companies when production becomes efficient.

Economies of scale can be achieved by mass production and ensuring less wastage and more efficiency in production process.

(4) Experience and Expertise:

A firm can also achieve competitive advantage by experience and expertise of decision makers.

MODULE 2

CHAPTER 2

GOVERNMENT AND TRADE

- **Government intervention:**

Governmental intervention is the intentional interference of a government in a country's economic system through regulatory actions.

It refers to a situation when a government is actively affecting decisions taken by individuals or organizations.

With the purpose of increasing welfare or pursuing certain economic and social goals, a government designs and enforces rules that aim to obtain results that could not be obtained under a market that is entirely free.

- **Approaches of government intervention:**

❖ Laissez-faire

Laissez-faire is a policy of minimum governmental interference in the economic affairs of individuals and society.

It is the policy of allowing private businesses to develop without government control.

The French phrase *laissez faire* literally means "allow to do," with the idea being "let people do as they choose."

If a government is laissez-faire, it does not have many laws and rules that control the buying and selling of goods and services.

At an organizational level, by being indecisive and uninvolved, laissez-faire leaders can lose the organization important opportunities. The damages can be especially costly when the market environment is unstable and changing fast. What is worse, laissez-faire leadership can result in poor crisis management.

❖ Interventionist approach

This approach refers to governmental interference in economic affairs at home or in political affairs of another country.

● Protectionism

Protectionism refers to the policy of protecting domestic industries against foreign competition by means of tariffs, subsidies, import quotas, or other restrictions placed on the imports of foreign competitors.

A typical example of protectionism is the Common Agricultural Policy (CAP) of the European Union. The European Union imposes significant tariff rates on a range of agricultural markets, seeking to protect the European farmers from imported agricultural goods.

● Rationales for intervention

(1) Economic rationales

The rationale for government intervention in an economy may concern the efficiency of the economy or the social outcomes of the economy.

1.1 Unemployment

One of the economic rationale of government intervention is to reduce unemployment by creating employment opportunities in domestic country.

Government intervention reduces imports and encourages exports, hence it establishes new employment opportunities in domestic market.

1.2 Infant industry argument

The infant industry argument is an economic rationale for trade protectionism.

The core of the argument is that nascent industries often do not have the economies of scale that their older competitors

from other countries may have, and thus need to be protected until they can attain similar economies of scale.

Newly born firms are generally not strong enough to compete with well established firms. Global firms enjoy economies of scale and are able to sell goods at lower price. On the other hand, newly born domestic firms have high costs and cannot sell their products at low prices, at least in the short run.

If the import of such products is not restricted, consumers will demand the imported product and not the domestically produced high cost goods.

The infant-industry argument for protection holds that governmental prevention of import competition is necessary to help certain industries move from high-cost to low-cost production.

1.3 Developing an industrial base

Industrialization is the process by which an economy is transformed from a primarily agricultural one to one based on the manufacturing of goods.

➢

- Countries seek protection to promote industrialization because that type of production:

  - Brings faster growth than agriculture.

  - Brings more income than primary products do.

  - Reduces imports and promotes exports.

  - Helps the nation-building process.

1.4 Retaliatory actions

Sometimes, Retaliatory actions need import restrictions.

Such measures are taken when exporters adopt unfair trade practices. In order to capture the market, exporters sell goods in foreign countries, even at a lower price than their cost structure justifies. Such practices disrupt the very industrial structure in the importing countries.

In order to counteract this move of exporters, the government in the importing country imposes restrictions on imports.

However, it is very difficult to prove unfair trade practices in some cases. Moreover, retaliatory measures often turn to be unending and they prove harmful for trading countries.

1.5 Balance of Payments

BOP is another justification either for imposing restrictions on import or for export encouragement or both.

In developing countries, axing the trade deficit lies at the root of import restrictions.

(2) Non economic rationales

2.1 Preventing shipments to "unfriendly" country

If the political relations are not friendly between two governments, trade is not encouraged between them. In cases where minimum trade is conducted, there is often the possibility of non-payment. So in such cases, trade is highly regulated in terms of commodities and price.

2.2 Preserving national identity

To sustain this collective identity that sets their citizens apart from those in other nations, countries limit foreign products and services in certain sectors.

For example, France imposes partial curb on the import of foreign films. This is out of fear that those films may affect badly the french culture and identity.

2.3 Maintenance of essential industries

Each and every country tries to develop some essential industries so that in case of any extra-ordinary situation, the supply of essential products is not completely hampered.

In order to protect these industries, the government regulates the export and import of these products.

For example, government subsidies the domestic production of silicon, which is made easily available to computer industry.

2.4 National security

Industry considered important for national security are often subjected to export or import regulations. The export and import of defence related products are cases in point.

● Instruments for trade control

(1) Tariff barriers

Tariff means duty levied by the government on imports.

Tariff which is levied on export is called Export Tariff and on import is called import Tariff.

Specific duty refers to the duty based on units of goods.

Ad valorem duty is the duty based on the value of goods.

Compound duty is duty based on both the unit and the value of goods.

(2) Non tariff barriers

Apart from tariff, import is restricted through non-tariff barriers (NTBs). NTBs are imposed to curtail imports, either to save scare foreign exchange or to provide a boost to domestic industries or to bring desired changes in the commodity pattern of the import.

2.1 Custom valuation

It has a direct influence on the price of the imported product. The higher the value, the greater the duty imposed on it.

In many countries valuation depends upon the stage of the production process. For example, semi-manufactured goods face a lower rate of duty than manufactured goods.

2.2 Import quota

Import quota is a quantitative restriction on import hence it affects the quantum of the import.

The importing country prescribes specific quantum beyond which a commodity in question cannot be imported during a particular year.

2.3 Voluntary Export Restraint (VER)

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

A voluntary export restraint 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. They are sometimes referred to as 'Export Visas'.

2.4 Import License

Some countries have a legislation ensuring that a particular commodity can be imported only using an import license. The license is issued by the government with proper care and after taking into account the availability of foreign exchange.

2.5 Anti dumping policy

Dumping is a process wherein a company exports a product at a price that is significantly lower than the price it normally charges in its home (or its domestic) market.

An anti-dumping duty is a protectionist tariff that a domestic government imposes on foreign imports that it believes are priced below fair market value.

2.6 Testing standards

Many countries set particular classification or labeling requirements or testing standard, which often inhibits imports.

Standards take a special place among non-tariff barriers. Countries usually impose standards on classification, labelling and testing of products to ensure that domestic products meet domestic standards, but also to restrict sales of products of foreign manufacture unless they meet or exceed these same standards.

2.7 Subsidy

Subsidy refers to cash payment made by the government to domestic producers in order to help cut the cost of production and sell the product at a lower price.

If the price of domestic goods is lower than the price of similar goods imported on account of subsidies, consumers will prefer to buy domestically produced goods, the import will automatically be restricted.

2.8 Counter-trade

The exchange of goods with goods between countries is referred to as counter-trade. This practice is common in case of aerospace and defence industries whereby the importer country may not have enough foreign currency to pay for imports.

(3) Currency controls

Currency control means restrictions on the convertibility of currency into other currencies, normally the internationally acceptable currencies. It is an effective tool in countries where the currency is not internationally acceptable.

An importer needs foreign currency for making payments for import, but when it is not easily available, the import is automatically restricted.

(4) Administration delays

With a view to restricting imports, bureaucracy creates unnecessary delays. Delays maybe made with respect to issue of license, custom valuation, product inspection etc.

Additionally, complicated procedural formalities maybe introduced to clear imports.

MODULE 2

CHAPTER 3

CROSS-NATIONAL CO-OPERATION

- **<u>GATT</u>**

The General Agreement on Trade and Tarrifs (GATT), begun in 1947, created a continuing means for countries to negotiate the reduction and elimination of trade barriers and to agree on simplified mechanisms for the conduct of international trade.

The members of GATT signed on an agreement of Uruguay round in April 1994 in Morocco for establishing a new organisation named WTO.

- **<u>WTO</u>**

The World Trade Organization (WTO) replaced GATT in January 1, 1995 as a continuing means of trade negotiations that aspires to foster the principle of trade without discrimination and to provide a better means of mediating trade disputes and of enforcing agreements.

The WTO is the world's largest international economic organisation, with 164 member states representing over 98% of global trade.

Members

Members, dually represented by the EU

Observer

Non-participant states

- **Objectives of WTO**

✓ To improve Standard of living of people in the menber countries.
✓ To ensure full employment and broad increase in effective demand.
✓ To enlarge production and trade of goods.
✓ To increase the trade of services.
✓ To ensure optimum utilization of world resources.
✓ To protect the environment.
✓ Sustainable development
✓ Focus on least developed countries

- **Advantages of WTO**

✓ To improve Standard of living of people in the member countries.
✓ To ensure full employment and broad increase in effective demand.
✓ To enlarge production and trade of goods.
✓ To increase the trade of services.
✓ To ensure optimum utilization of world resources.
✓ To protect the environment.
✓ Sustainable development
✓ Focus on least developed countries

● Regional economic integration

Regional economic integration occurs when countries come together to form free trade areas or custom unions, offering members preferential trade access to each others' markets.

Economic integration or regional economic grouping represents some kind of preferential economic arrangement among member countries, where they co-operate with one another in many ways and eliminate restrictions on the intra-region flow of goods, services, capital and labour.

Efforts at regional economic integration began to emerge after World War II as countries saw benefits of cooperation and larger market sizes.

A Regional trade agreement is the result of economic integration of various trading areas of different countries and it is also known as Regional economic integration, Regional trade areas, Regional economic forces, and Regional Groupings.

Major trading groups

- ✓ EU — European Union
- ✓ NAFTA — North American Free Trade Agreement
- ✓ ASEAN — The Association of South-East Asian Nations
- ✓ BRICS — Brazil, Russia, India, China, and South Africa
- ✓ SAARC — The South Asian Association for Regional Co-operation

EUROPEAN UNION

INTRODUCTION

- EU was founded on 1st November 1993.

- The **European Union (EU)** is a political and economic union of 28 member states that are located primarily in Europe.(currently 27 member states)
- Headquarters of EU is in Brussels and Belgium.
- EU policies aim to ensure the free movement of people, goods, services and capital within the internal market.

- An estimated population of EU in 2021 is 44,70,07,596.

(9.78% of world population)

- It has an area of 44,75,757 km^2

(7th largest area of dependent territories)

- In 2017, EU generated a nominal GDP of 19.670 trillion dollar.

(24.6% of global GDP)

MAJOR COUNTRIES IN EU

The EU countries are:

- Austria, Belgium, Bulgaria, Croatia, Cyprus, Czechia, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain and Sweden.

WHY THE EUROPEAN UNION?

- The EU's mission in the 21st century is to:

- Maintain and build on the peace established between its member states.
- Bring European countries together in practical cooperation.
- Ensure that European citizens can live in security.
- Promote economic and social solidarity (unity).
- Preserve European identity and diversity in a globalised world.

THE EUROPEAN UNION

THE EU SYMBOLS

The motto: united in diversity

The EU anthem: ode to joy

Currency: Euro

The EU flag

The EU day: 9th may

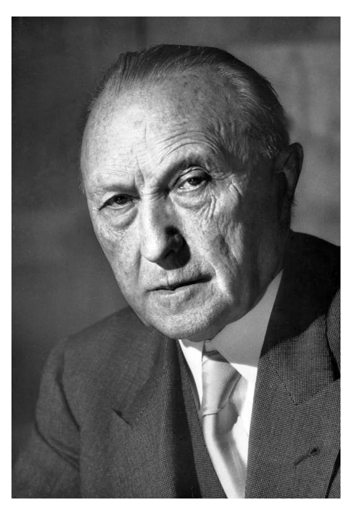
24 OFFICIAL LANGUAGES

THE EU CHARTER OF FUNDAMENTAL RIGHTS

COMMON VALUES

- Freedom of speech
- Freedom of the press
- Freedom of religion
- Freedom of association
- Gender equality
- Protection of minorities
- Against the death penalty
- Protection of the environment

FOUNDERS



Conrad
ADENAUER

Robert
SCHUMAN

Winston
CHURCHILL

Alcide
DE GASPERI

Jean
MONNET

EURO:
A SINGLE CURRENCY FOR EUROPEANS

Why the euro?

- No fluctuation risk and foreign exchange cost
- Stable prices for consumers
- Closer economic cooperation between EU countries

THE EUROPEAN CENTRAL BANK: MANAGING THE EURO

- Ensures price stability
- Controls money supply and decides interest rates
- Supervises that banks are safe

Mario Draghi
President of the Central Bank

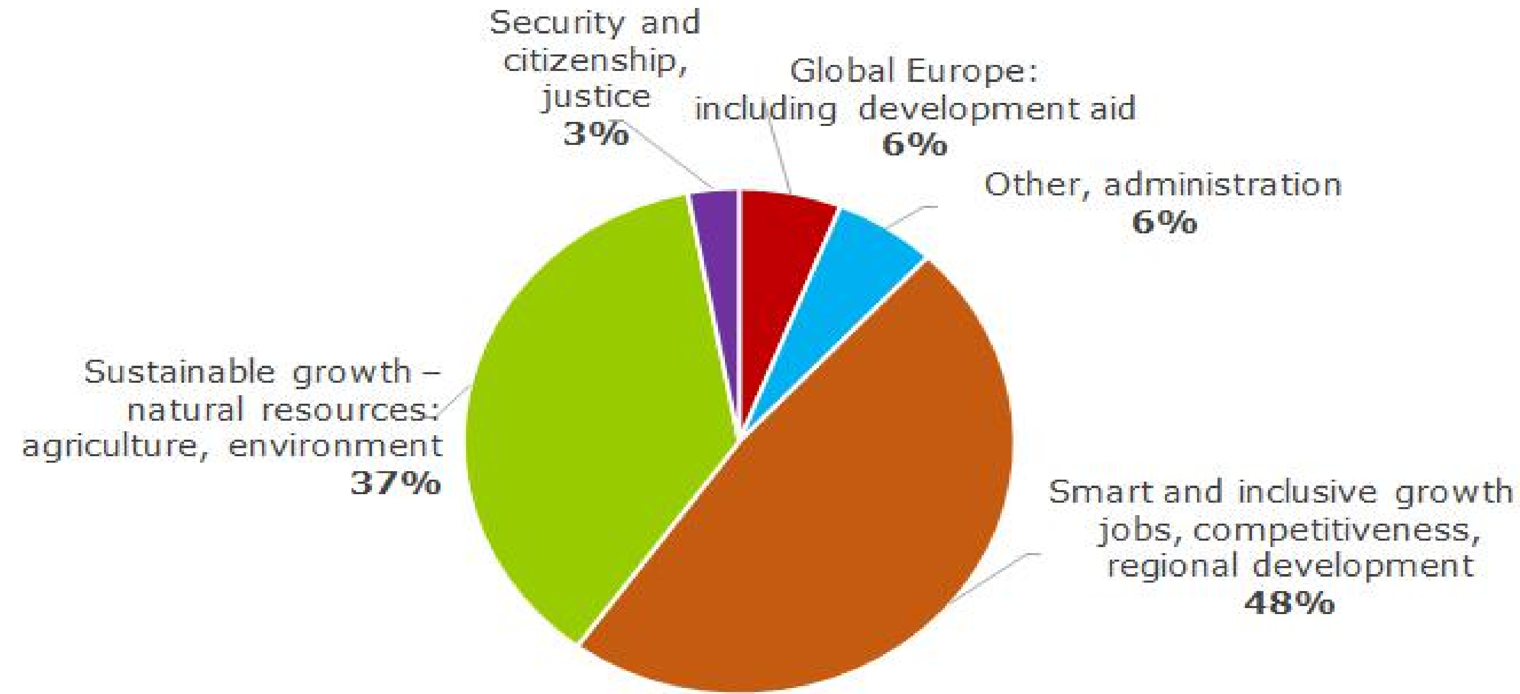
PROTECTING CONSUMER RIGHTS

- **As a consumer you are protected by basic laws all over the EU, even when you travel or shop online:**

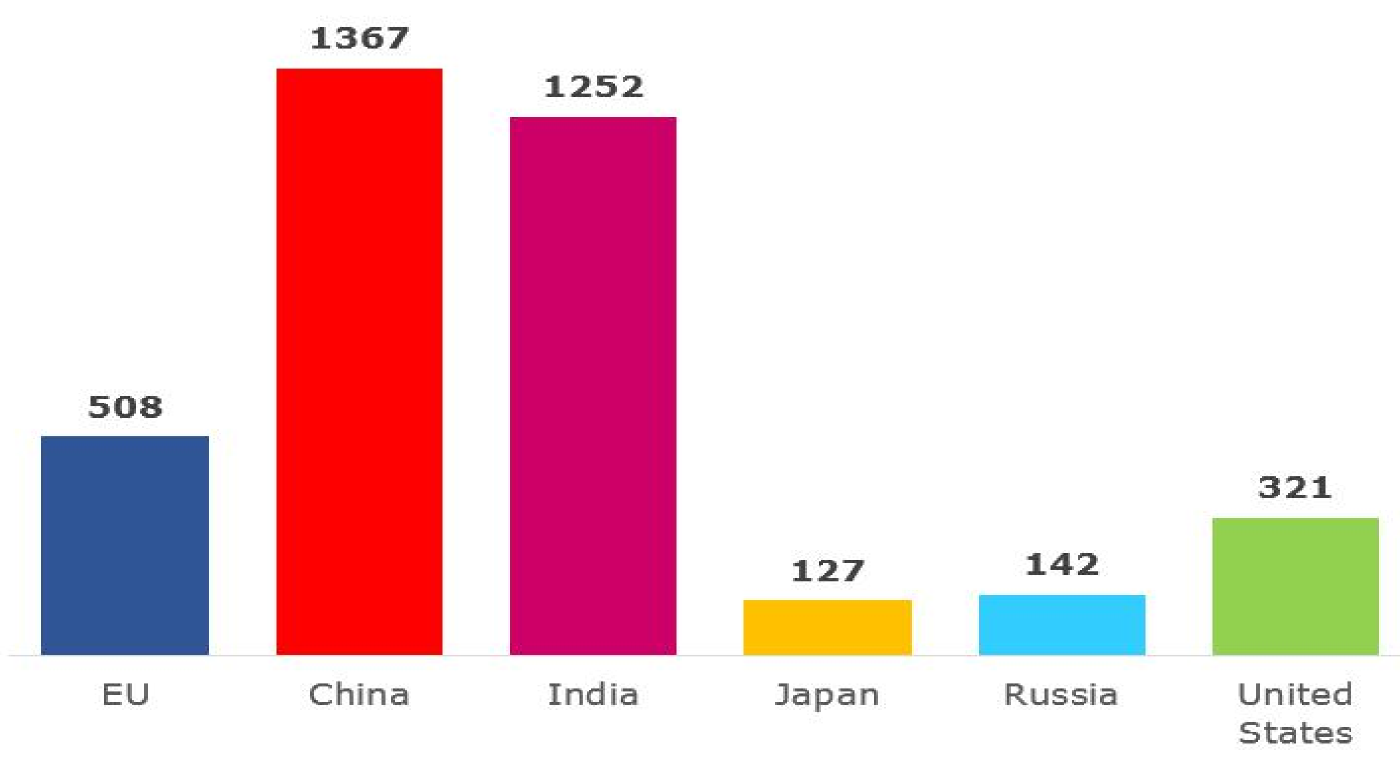
- Clear labelling
- Health and safety standards
- Unfair practice in contracts prohibited
- Passengers' rights, such as compensation for long delays
- Help to resolve problems

HOW DOES EUROPE SPEND IT'S MONEY (BUDGET OF EU)

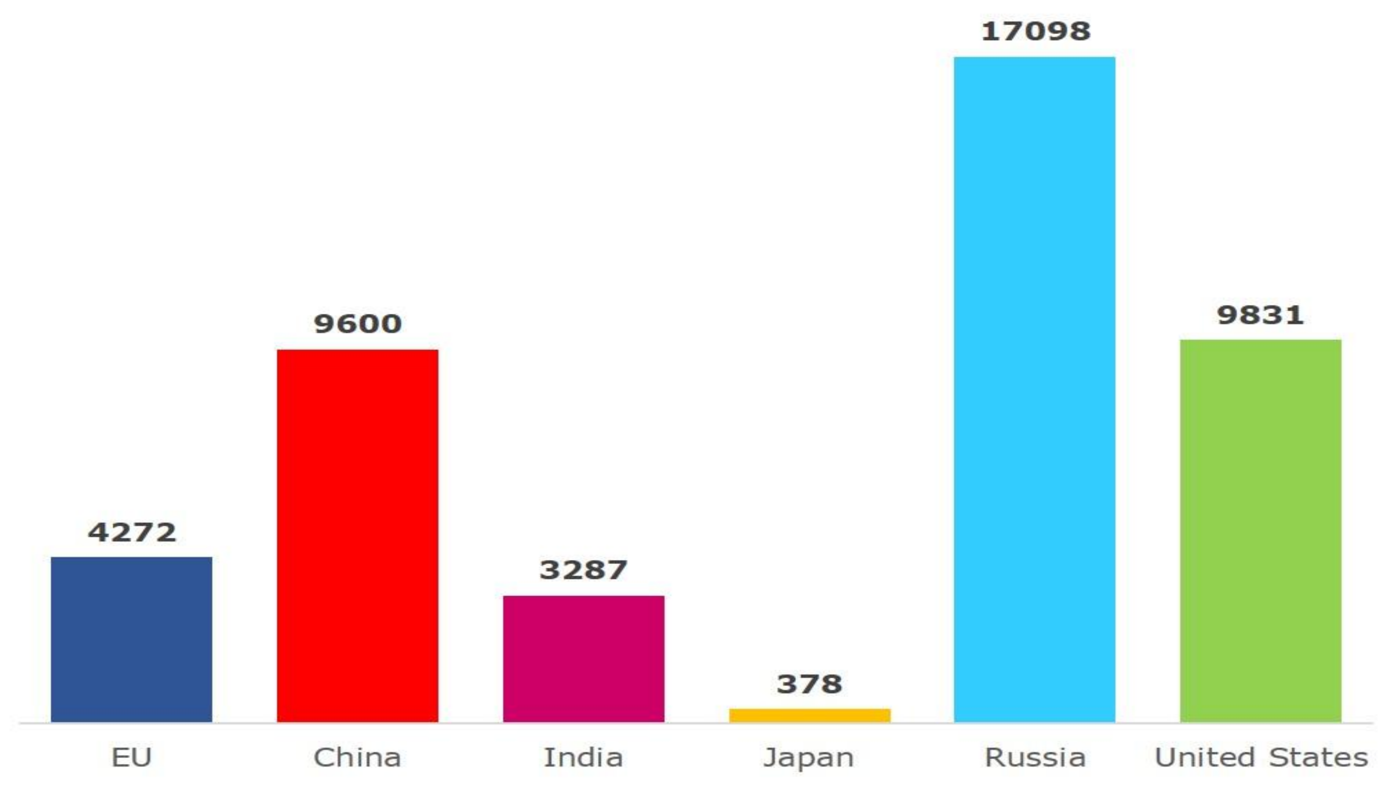
2017 EU budget: € 157.9 billion



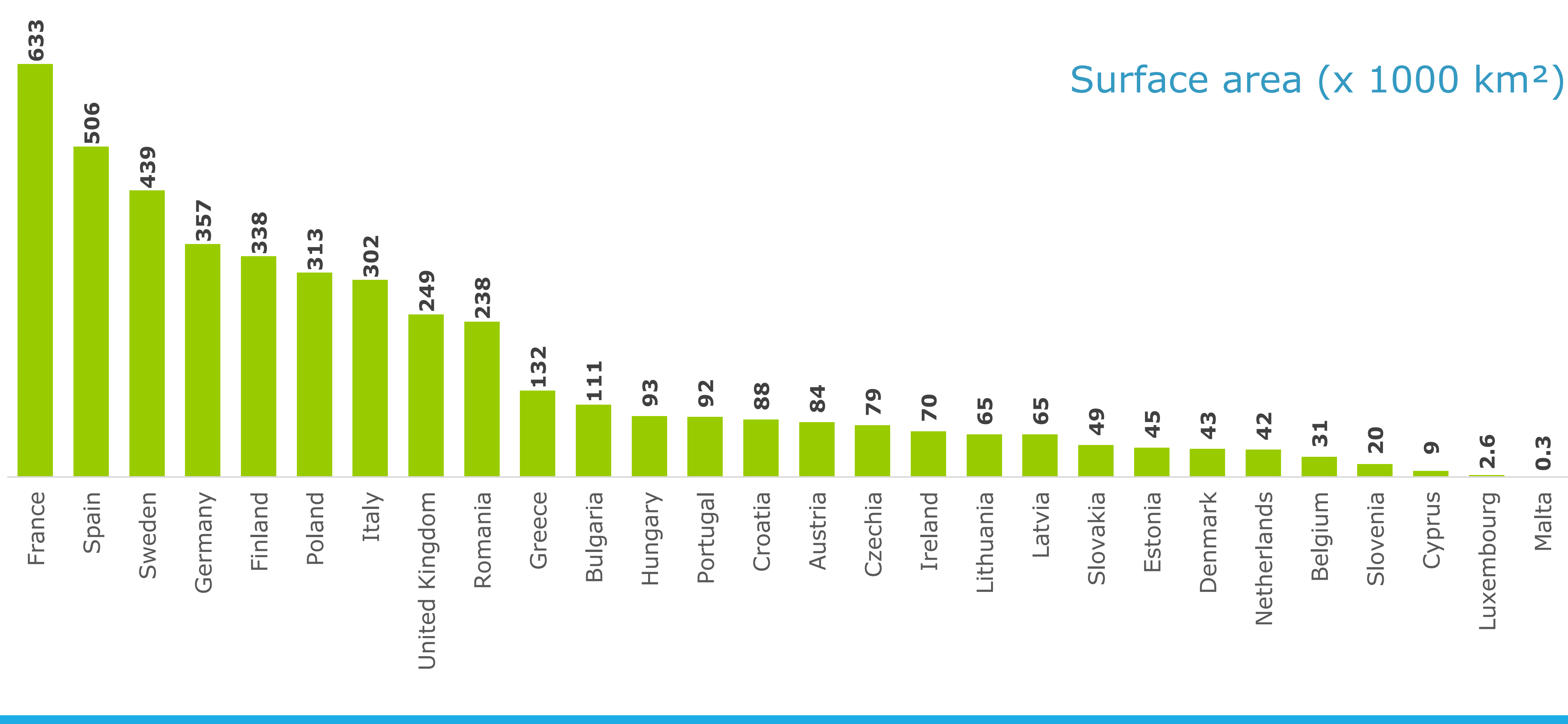
POPULATION OF EU AS COMPARED TO OTHER COUNTRIES



SURFACE AREA OF EU AS COMPARED TO OTHER COUNTRIES



HOW BIG ARE THE EU COUNTRIES?



SUMMIT AT THE EUROPEAN COUNCIL

Summit of heads of state and government of all EU countries

Held at least 4 times a year

Sets the overall guidelines for EU policies

President: Donald Tusk

NAFTA
North American Free Trade Agreement

INTRODUCTION

- The North American Free Trade Agreement (NAFTA) is a comprehensive trade agreement that sets the rules of trade and investment between Canada, The United States and Mexico.

- NAFTA has systematically eliminated most tarrif and non-tarrif barriers to free trade and investment between the three NAFTA countries.

- Establishment: 1st january 1994
- Members: Canada, Mexico & United States
- Official languages: English, French and Spanish
- Secretariats: Mexico city, Ottawa, Washington D.C.
- NAFTA supplements NAAEC & NAALC

OBJECTIVES Of NAFTA

- To eliminate trade barriers & facilitate the cross-border movements of goods and services between the parties.
- To promote conditions of fair competition
- To provide adeqaute and effective protection & enforcement of intellectual property rights in each territory.
- To create effective procedures for the implementation and application of this agreement for its joint administration & for resolution of disputes.

NAAEC

- The North American Agreement on Environment Cooperation is an environmental agreement between US, Canada and Mexico as a side treaty of the NAFTA.
- The agreement came into effect on January 1, 1994.
- The agreement consists of a declaration of principles and objectives concerning the protection of environment as well as concrete measures to further cooperation on these matters between the three countries.

NAALC

- The North American Agreement on Labor Cooperation was signed on september 14, 1993, by the presidents of Mexico and US and the Prime Minister of Canada.
- It entered into force on january 1, 1994.
- The NAALC was the first international agreement on labor to be linked to an international trade agreement.

- It provides a mechanism for member countries to ensure the effective enforcement of existing and future domestic labor standards and laws without interfering in the sovereign functioning of the different national labor syastems, an approach that made it novel and unique.

BENEFITS OF NAFTA

- Benefits the importers by reduced or duty free goods.
- Trade and investment levels in North America have increased, bringing strong economic growth, job creation and better prices and selection in consumer goods.
- Increased trade among all three countries and market access within each country also increased considerably.
- A market place that is increasingly driven more by supply and demand than by barriers to commerce.

LIMITATIONS OF NAFTA

- It has negative impacts on farmers in Mexico who saw food prices fall based on cheap imports from US agro business.
- It has negative impacts on US workers in manufacturing and assembly industries who lost jobs.
- Critics also argue that NAFTA has contributed to the rising levels of inequality in both the US and Mexico.
- Some economists believes that NAFTA has not been enough (or worked fast enough) to produce an economic convergence, nor to substantially reduce poverty rates.

CONTRIBUTION TO NAFTA

MEMBER COUNTRY	CONTRIBUTION IN SUPPLY
United States	Technology, Services, Data Processing, Medical and Space Research and Capital
Canada	Mineral,Forest products, Energy and Technological expertise
Mexico	Labors, Petroleum and Agricultural products

CONCLUSION

- The NAFTA revolutionized trade and investment in North America, helping to unlock region's economic potential.
- It has helped to stimulate economic growth and create higher-paying jobs across North America.
- It has provided North American business with better access to materials, technologies, investment capital and talent available across North America.

BRICS

ORDEM E

BRIC

- BRIC stands for Brazil, Russia, India and China
- Goldman Sachs predicted in 2001 that some leading economy of the world will emerge to give competition to western world..
- BRIC is an international political organization of leading emerging economies, its Five members are all developing industrialized countries.
- Biggest and fastest growing emerging economies.

- South Africa has been asked to join the BRIC group of major emerging markets.
- Officially admitted as a BRIC nation on December 24, 2010.
- South Africa stands at a unique position to influence African economic growth and investment.

- China is South Africa’s largest trading partner
- India wants to increase commercial ties with Africa
- South Africa was brought into BRIC, "not only South Africa but a larger African market of a billion people,"

OBJECTIVES OF BRICS

- To achieve regional development
- To remove trade barriers
- Economic development
- Optimum use of resources
- Builiding relationship

BRICS SUMMIT

- The BRIC countries met for their first official summit on 16 June 2009, in Yekaterinburg, Russia.

- To Discuss the current global financial crisis, global development, and further strengthening of the BRICS group.

BRICS Summits

Participants Summit		Date	Host country	Host leader	Location
1st	BRIC	Jun, 2009	Russia	Dmitry Medvedev	Yekaterinburg
2nd	BRIC	Apr, 2010	Brazil	L.I. Lula da Silva	Brasília
3rd	BRICS	Apr, 2011	China	Hu Jintao	Sanya
4th	BRICS	Mar, 2012	India	Manmohan Singh	New Delhi
5th	BRICS	Mar, 2013	S Africa	Jacob Zuma	Durban
6 th	BRICS	Jul, 2014	Brazil	Dilma Rouseff	Fortaleza
7th	BRICS	Jul, 2015	Russia	Vladimir Putin	Ufa
8th	BRICS	Oct, 2016	India	Narendra Modi	Goa

PTI GRAPHICS

PATH TO 2050

Already BRICS accounts for:

- 46 per cent of the World's Population,
- 25.9 per cent of its Total Geographic Area,
- 30 per-cent of Global GDP

- By 2050, BRICS countries expected to accounts 60% of global GDP.

- BRICS could be larger economies than the United States and the developed economies of Europe within 40 years.
- China and India will become world's dominant suppliers of manufactured goods and services.
- Brazil and Russia will become dominant suppliers of raw materials.

ASEAN

ASSOCIATION OF SOUTH EAST ASEAN NATIONS

INTRODUCTION

- The ASEAN was established on August 8, 1967.

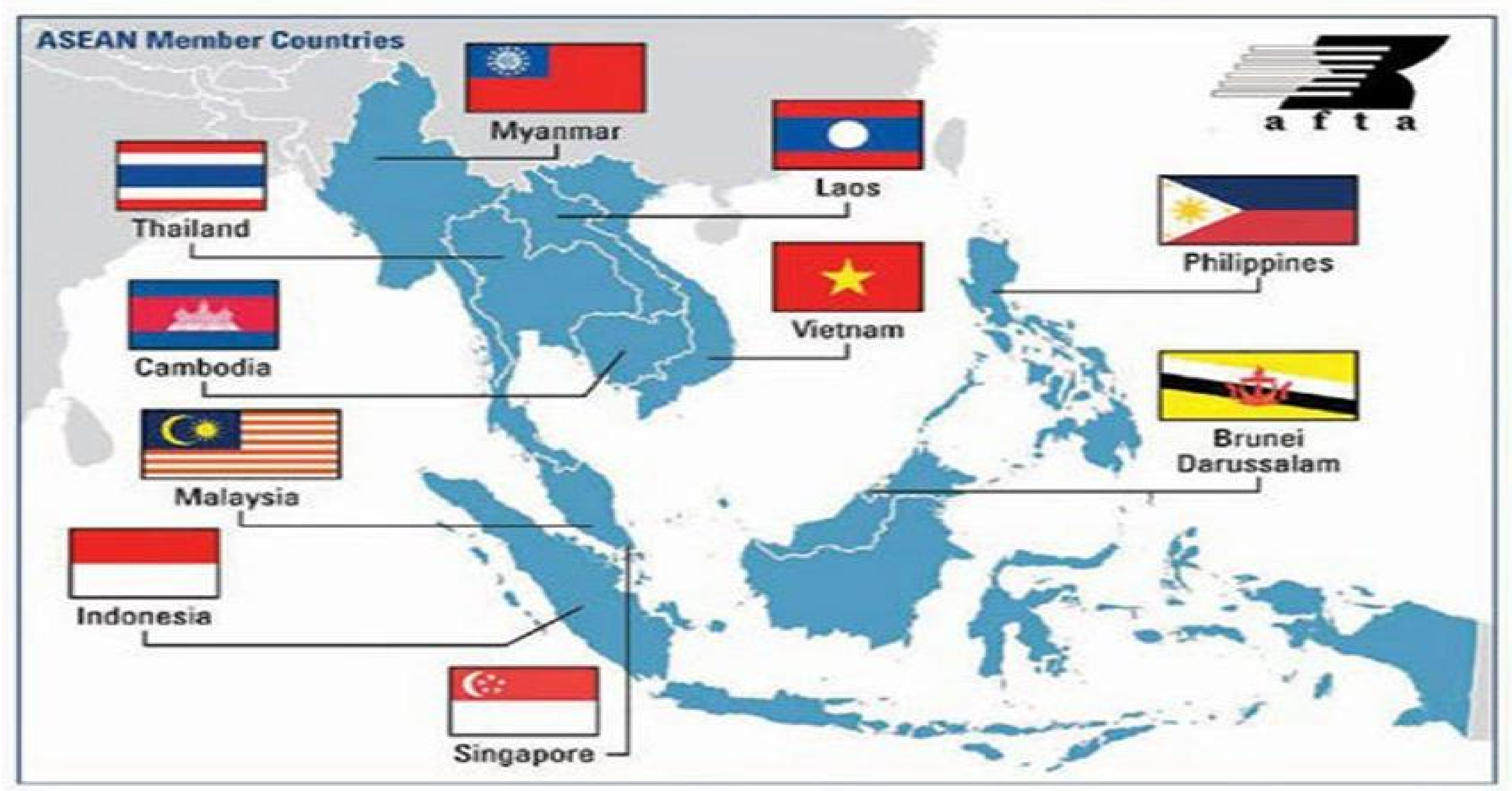
- The foreign Ministers of Indonesia, Malaysia, Philipines, Singapore and Thailand - held a meeting in the Department of Foreign Affairs at Bangkok, thailand; and signed a document.

- By virtue of that document, The Association of SouthEast Asian Nations (ASEAN) came into existence.

- ASEAN is a regional grouping that promotes economic, political and security co-operation among its member countries.

- **Member Countries :**

Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam.


ASEAN Member Countries
Myanmar
Laos
Thailand
Philippines
Vietnam
Cambodia
Brunei Darussalam
Malaysia
Indonesia
Singapore
a f t a

FOUNDING FATHERS OF ASEAN

Adam Malik	Indonesia
Narciso R. Ramos	Philippines
Tun Abdul Razak	Malaysia
S. Rajaratnam	Singapore
Thanat Khoman	Thailand

ASEAN EMBLEM

- The **BLUE** represents peace and stability.
- The **RED** depicts courage and dynamism.
- The **WHITE** shows purity.
- The **YELLOW** symbolizes prosperity.

- The stalks of padi in the centre of the emblem represent the dream of ASEAN's founding fathers for an ASEAN comprising all the countries in SouthEast Asia, bound together in friendship and solidarity.
- The circle represents the Unity of ASEAN.

OBJECTIVES OF ASEAN

- To accelarate economic growth, Social progress and cultural development in the region through joint endeavours in the spirit of equality and partnership in order to strengthen the foundation for a prosperous and peaceful community of SouthEast Asian Nations.

- To promote regional peace and stability through abiding respect for justice and the rule of law among countries of the region.

- To maintain close and beneficial cooperation with existing international and regional organisations with similar aims and purposes.

- To promote active collaboration and mutual assistance on matters of common interest in the economic, social, cultural, technical, scientific and administrative fields.

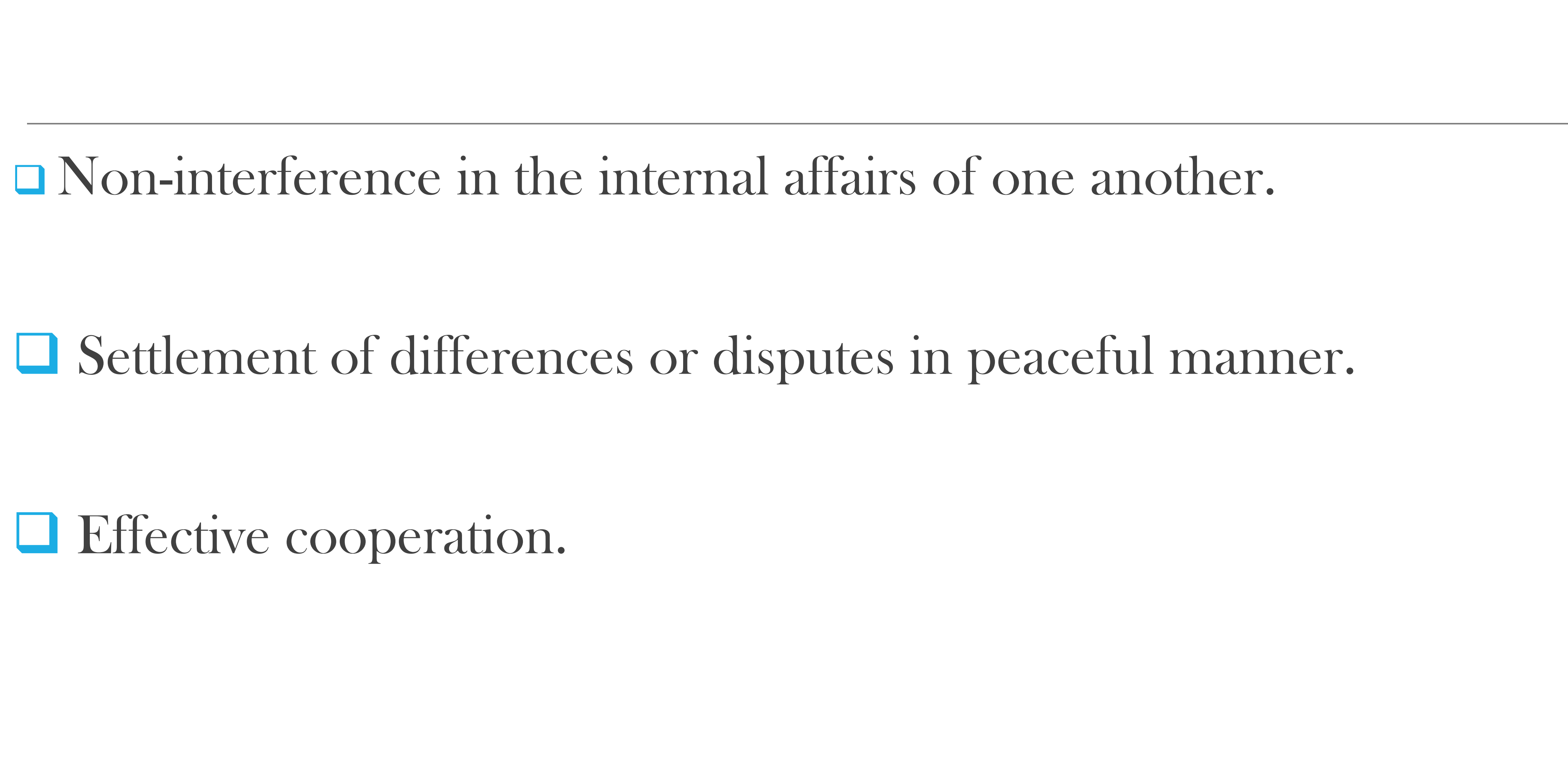
- To provide assistance to each other in the form of training and research facilities in the educational, professional, technical and administrative spheres.

PRINCIPLES OF ASEAN

- In 1976, the members signed the **Treaty of Amity and cooperation,** emphasizing ASEAN's promotion of peace, friendship and cooperation to build solidarity:

- Mutual respect for the independence, sovereignty, equality, territorial integrity, and national identity of all nations.

- The right for every state to lead its national existence free from external interference or coersion.


Non-interference in the internal affairs of one another.
Settlement of differences or disputes in peaceful manner.
Effective cooperation.

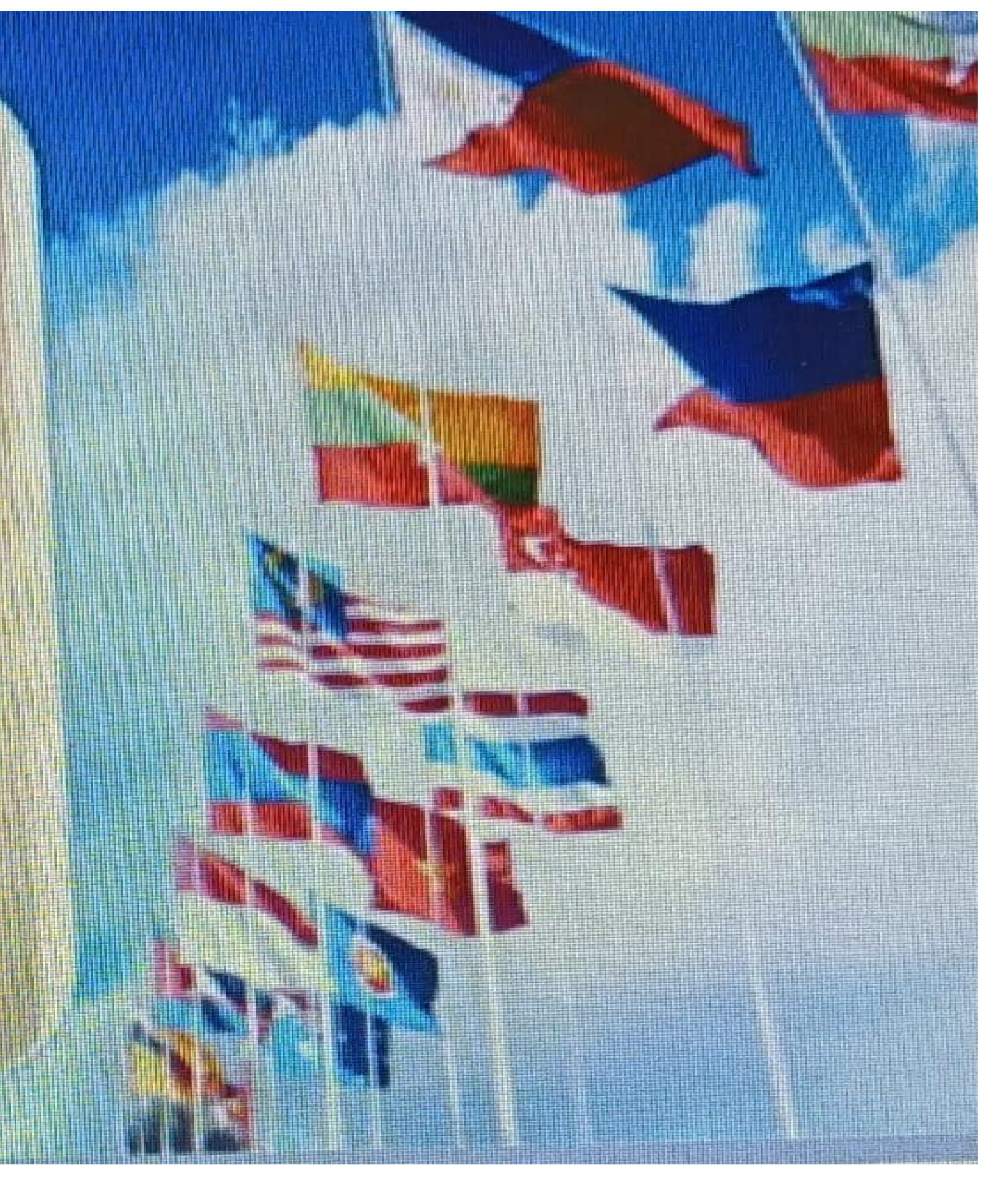
“ONE VISION, ONE IDENTITY, ONE COMMUNITY”

MALAYSIA
LAOS
VIETNAM
BRUNEI

THAILAND

PHILIPPINES
SINGAPORE
MYANMAR
CAMBODIA
INDONESIA

WE ARE ASEAN



SAARC

South Asian Association
for Regional Cooperation

INTRODUCTION

- SAARC was founded in Dhaka on 8 December 1985.
- The organization promotes development of economic and regional integration.
- SAARC comprises 3% of the world's area, 21% of the world's population and 4.21% (US$3.67 trillion) of the global economy, as of 2019.

SECRETARIAT

- The SAARC secretariat was established in Kathmandu, Nepal on 16th January 1987 and was inaugurated by Late King Birendra Bir Bikram Shah of Nepal.

- The SAARC Secretariat and Member states observe 8 december as the SAARC charter day.

SAARC MEMBERS

- In April 2007, at the Association's 14th Summit, Afghanistan became its eighth member.

OBJECTIVES OF SAARC

- To promote welfare of the people of South Asia and to improve their quality of life.

- To accelerate economic growth, social progress and cultural development in the region and to provide all individuals the opportunity to live in dignity and to realize their full potential.

- To contribute to mutual trust, understanding.

- To promote active collaboration and mutual assistance in the economic, social, cultural, technical and scientific fields.

- To strengthen cooperation with other developing countries.

- To strengthen cooperation with international and regional organisations with similar aims and purposes.

SAPTA

- The SAARC Preferential Trading Arrangement (SAPTA) reflected the desire of the Member States to promote and sustain mutual trade and economic cooperation within the SAARC region through the exchange of tariff concessions.

- Date of signing of the agreement : 11th April 1993
- Date of coming into effect : 7th December 1995

SAFTA

- The South Asian Free Trade Area (SAFTA) is an agreement reached on January 6, 2004, at the 12th SAARC summit in Islamabad, Pakistan.

- It created a free-trade area of 1.6 billion people in Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka to reduce customs duties of all traded goods to zero by the year 2016.

- The SAFTA agreement came into force on January 1, 2006

SAARC

Thank YOU

MBA SEMESTER 3

INTERNATIONAL BUSINESS

(4539281)

MODULE 3

CHAPTER 1

FOREIGN EXCHANGE

● Introduction

The foreign exchange market (Forex or currency market) is a global decentralized or over-the-counter (OTC) market for the trading of currencies. This market determines foreign exchange rates for every currency. It includes all aspects of buying, selling and exchanging currencies at current or determined prices. In terms of trading volume, it is by far the largest market in the world, followed by the credit market.

- The term Foreign exchange implies two things:
  Foreign currency
  Exchange rates

- Foreign Exchange generally refers to **foreign currency**.
  Example: For India it is Dollar, Euro, Yen etc.

- **Exchange rate** is the price of currency in terms of another currency.

- **Meaning**

oreign exchange, or forex, is the conversion of one country's currency into another. In a free economy, a country's currency is valued according to the laws of supply and demand.

According to Hartly Withers,"Foreign Exchange is the art and science of International Monetary Exchange".

The Forex market is the world's largest financial market. over $4trillion worth of currency are being traded each day.

➢ The amount of money traded in a week is bigger than the entire annual GDP of The United States.

(which is 22.675 trillion dollar)

➢ The Forex market is the world's largest financial market. over $4trillion worth of currency are being traded each day.

➢ The amount of money traded in a week is bigger than the entire annual GDP of The United States.

(which is 22.675 trillion dollar)

Exchange rate:

The price of one currency in terms of another currency.

Exchange rate is an amount of the domestic currency you will have to pay in order to obtain a Unit of a foreign currency.

Foreign Exchange Market:

The market in which these transactions take place is the foreign-exchange market.

Currency Appreciation:

Increase in value of the currency.

Currency Depreciation:

Decrease in value of the currency.

- **RBI**

The Reserve Bank of India is India's central bank and regulatory body and is responsible for the issue and supply of the Indian rupee and the regulation of the Indian banking system.

It also manages the country's main payment systems and works to promote its economic development.

RBI was established on 1st April 1935

- **IMF**

The International Monetary Fund (IMF) is an organization of 190 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.

The IMF formally came into existence on 27th December 1945.

- **Types of exchange rate**

(1) Fixed and Floating Exchange rate:

Fixed exchange rate system is a system in which exchange rate for a currency is fixed by the government.

Floating/Flexible exchange rate system refers to a system in which exchange rate is determined by forces of demand and supply of different currencies in the foreign exchange market.

(2) Direct and Indirect exchange rates:

- The quote is **direct** when the price of one fixed unit of foreign currency is expressed in terms of the variable amounts of domestic currency.

  Example: 1$ = 74.51/-

It is also known Direct Quote.

The given Quote for one unit of foreign currency is known as Direct Quote.

- The quote is **indirect** when the price of one unit of domestic currency is expressed in terms of Foreign currency.

  Example: 1/- = 0.013 $

  i.e. 1 / 74.51

It is also known as Indirect Quote.

The given Quote for one unit of domestic currency is known as Indirect Quote.

- ✓ In order to classify a given exchange rate as direct quote or indirect quote, one of the currencies in the quote must be the local currency.

BID-ASK

Foreign exchange rate is quoted in “Bid” and “Ask” format.
BID is buying rate, ASK is a selling rate.

Example: 1$ = INR 74.51/75.50

Ask rate is majorly higher than Bid rate.

The difference between BID and ASK rate is called as “SPREAD” (ASK-BID).

Foreign Exchange Market

Foreign Exchange Market is that market in which national currencies are traded for one another.

Besides, transfer of funds from one country to another, speculation is an important dimension of foreign exchange market.

● <u>Major players in foreign market</u>

(1) Central banks

A central bank is the predominant monetary authority of a nation. Central banks obey individual economic policies. They are usually under the authority of the government. They facilitate the government's monetary policies (dealing in keeping the supply and the availability of money) and to make strategies to smoothen out the ups and downs of the value of their currency.

Central banks, which represent their nation's government, are extremely important players in the forex market. A central bank is responsible for fixing the price of its native currency on forex.

(2) Commercial banks

The banks take part in the currency markets to neutralize the foreign exchange risks of their own and that of their clients. The banks also seek to multiply the wealth of their stockholders.

There are many types of banks in a forex market; they can be huge or small. The most sizeable banks deal in huge amounts of funds that are being traded at any instant.

In terms of forex trading activity, the main role of banks is to serve as middlemen for the other market participants. Their objective is to make profits through "market making", which means that they offer their clients a "buy" price and a "sell" price.

(3) Institutional investors

An institutional investor buys, sells, and manages stocks, bonds, and other investment securities on behalf of its clients, customers, members, or shareholders.

Institutional investors have a profound impact on stock prices because they account for most of the trading, their buying can send a stock price up and their selling can send a stock price down. Institutional talk can also affect stock prices, although its impact is likely to be short-term.

They include investment and insurance companies and hedge funds. They represent 30% of all foreign exchange transactions.

(4) Multinational company

MNCs participate in forex trading in order to convert their money during import or export activities.

These players are identified by the nature of their business policies that include:

(a) how they get or pay for the goods or services they usually render and

(b) how they involve themselves in business or capital transactions that require them to either buy or sell foreign currency.

Their transactions represent approximately 5% of all global forex transactions.

(5) Private investors/ individuals

Private investors have recently been trading the forex market as well, thanks to the internet, which allows them to have real-time access to currency exchange rates. Today, their transaction volume adds up to over 5% of all forex transactions.

(6) Brokers

Brokers allow private individuals to access the forex market by transmitting their clients' orders to commercial banks.

● Major foreign exchange markets

(1) Spot market

Spot market of foreign exchange is that market which handles only spot transactions or current transactions.

Spot rate of exchange is that rate which happens to prevail at the time when transactions are made.

(Today's rate on Today's Date)

In the spot market, transactions involving currency pairs take place. It happens seamlessly and quickly. The transactions require instant payment at the prevailing exchange rate which is also known as the spot rate. The traders in the spot market are not exposed to the uncertainty of the market, which can lead to an increase or decline in the price between the agreement and trade.

(2) Forward market

Forward Market is a market where there is customized contract between two parties to purchase and sale of foreign exchange which are contracted today and at a price agreed today but are implemented in future.

(Today's Fixed Rate on Future Date)

In forward market, deals are similar to future market transactions. In this case, the parties will negotiate the terms of the transactions and the terms agreed-upon can be negotiated and altered as per the needs of the concerned parties. The forward market has higher flexibility as compared to the futures market.

(3) Future market

Forex futures are standardized exchange-traded currency derivative contracts obligating the buyer and seller to transact at a set price and predetermined time.

Hedging, to reduce exposure to the risk created by currency fluctuations, and speculation, to potentially generate profits, are the two main uses for forex futures.

The transactions in the futures market require future payment and distribution at a previously agreed upon exchange rate which is known as the future rate. The transaction or agreement is more formal in nature which ensures that the terms of the transaction are set in stone and cannot be altered. Traders who conduct the majority of the transactions enjoy a consistent return on the assets. Regular traders prefer a future market transaction.

(4) Option market

In the options market, the currency of exchange from one denomination to the other is agreed upon by the investor at a specific rate and on a specific date. The investor has a right to convert the currency on a future date but there is no obligation to do so.

An option is type of a contract between 2 parties where one person grants the other person the right, but not the obligation, to buy a specific asset at a specific price within a specific time period.

- It mat be two types:
- ✓ Call Options
  - option to Buy
  - successful when Price increases
- ✓ Put Options
  - option to Sell
  - successful when price decreases

(5) Swaps

A foreign currency swap is an agreement to exchange currency between two foreign parties, in which they swap principal and interest payments on a loan made in one currency for a loan of equal value in another currency.

When there is a simultaneous borrowing and lending of two types of currencies between two investors, it is known as a swap transaction. Here, one investor borrows a currency and in turn, pays in the form of a second currency to the second investor. The transaction is done to pay off their obligations without having to deal with a foreign exchange risk.

- **<u>Determining exchange rates</u>**

➢ Exchange rate = $\frac{\text{Money In after exchange}}{\text{Money before exchange}}$

- ✓ For instance, say you want to convert Euros to US dollars. At the time of this revision, 1 Euro is worth 1.09 US dollar. What will be your Exchange rate?
- ✓ Your exchange rate is 1.09.

- ✓ If you're planning to convert 1500 Euros in USD. what would you Do?
- ✓ Would multiply 1500 by 1.09.
- ✓ The answer, 1635, is how much money you'll have in dollars after the exchange.

At the most basic level, exchange rates are determined by demand and supply of one currency relative to the demand and supply of another.

However differences in relative demand and supply explain the determination of exchange rates.

(1) Purchasing power parity

Purchasing power parity (PPP) is an economic theory of exchange rate determination.

It states that the price levels between two countries should be equal. This means that goods in each country will cost the same once the currencies have been exchanged.

It is based on two currencies involved in the calculation of the exchange rate having same purchasing power for the same good sold in the two countries.

- **For example**, if the price of a Coca Cola in the UK was 100pence i.e. 1Pound, and it was $1.50 in the US, then the GBP/USD exchange rate should be 1.50

(the US price divided by the UK's) according to the PPP theory.

However, if you were then to look at the market exchange rate of the GBP/USD pair, it is actually closer to 1.35. The discrepancy occurs because the purchasing power of these currencies is different.

- The economic theory is often broken down into two main concepts:

1.1 Absolute purchasing power parity

Absolute purchasing power parity (APPP) is the basic PPP theory, which states that once two currencies have been exchanged, a basket of goods should have the same value. Usually, the theory is based on converting other world currencies into the US dollar.

Pi = E*Pf

Where,

Pi = Price in domestic country

Pf = Price in foreign country

E = Exchange rate

- For Example,

A price of 1 KG apple in India is 150₹ and A price of 1 KG apple in US is 2$

while current exchange rate is 74.51₹/USD

= 2*74.51

= **149.02**

If we continue previous example, if the price of a can of Coca Cola was $1.50, APPP would suggest that a can of Coca Cola in any other country should cost $1.50 after you've converted its local currency into USD.

If this does not hold true, then APPP suggests that the currency exchange rate will change over time until the goods are of equal value – as without any barriers to trade, there should be an equilibrium in the price of goods.

This is a completely price-level theory, which only looks at the exact same basket of goods in each country, with no other factors included.

However, the theory ignores the existence of inflation and consumer spending, as well as transportation costs and tariffs, which can impact the short-term exchange rate.

1.2 Relative purchasing power parity

While it maintains that the value of the same good in different countries should equal out over time, RPPP suggests that there is a correlation between price inflation and currency exchange rates.

The theory suggests that inflation will reduce the real purchasing power of a currency, so in order to properly adjust the PPP, inflation must be taken into account.

For example, if the UK had an annual inflation rate of 2%, then one unit of pound sterling would be able to purchase 2% less per year.

One we add this concept onto APPP, we can see that inflation rates will account for part of the change in the power of currencies.

So suppose that the USA has a 2% inflation rate, while India has a 5% inflation rate.

This means that after one year, the price of a basket of goods in India has increased by 5%, while the same basket of goods in the USA has only increased by 2%.

$$S_t = S_0 \left[\frac{1 + inflation_A}{1 + inflation_B} \right]^t$$

S_0 = initial spot rate
t = periods into the future
S_t = estimate future spot rate

Inflation A is 5%

Inflation B is 2%

Spot rate is 74.51₹ per Dollar

n is 1 Year

What will be Future spot rate?

76.70₹

(2) Interest rate parity

Interest rate parity (IRP) is a theory according to which the interest rate differential between two countries is equal to the differential between the forward exchange rate and the spot exchange rate.

IRP theory states that equilibrium is achieved when the forward rate differential is approximately equal to the interest rate differential.

Interest rate parity is the fundamental equation that governs the relationship between interest rates and currency exchange rates.

The exchange rate between two currencies purely depend upon the interest rates prevailing in the two respective countries.

YEAR	EXCHANGE RATE (INR per USD)
1947	3.30
1975	8.39
1985	12.38
1995	17.01
2000	43.50
2005	43.47
2010	46.21
2015	66.79
2020	70.96
Current	74.51

By the time value of a Dollar in terms of an Indian rupee has gone substantially high.

There can be so many factors contributing to the appreciation of a Dollar or we can say the depreciation of an Indian Rupee.

If we look into Interest Rate Parity Theory, it conveys that the only factor that is responsible for the changes in exchange rate is the difference in Interest Rate Prevailing in the two countries.

As per IRP theory, the country in which interest rate is higher than the other country, the value of domestic currency gets devalued.

- That means:

  If the Interest Rate is higher, currency gets devalued.

  If the Interest Rate is lower, currency gets appreciated.

For Example,

Interest Rate prevailing in India = 12%

Interest Rate prevailing in US = 7%

- ➢ What would you do to get advantage of this situation?
- ✓ You can borrow from US @ 7% interest and invest in India @ 12%.

- ➢ What would you earn or loose out of this transactions?
- ✓ You would earn a differential interest of 5%.

- ◆ Continuing with the previous example,

Suppose: Spot rate is $1 = 74₹

You Borrowed $1,00,000 from US @ 7%

Invested 74,00,000₹ in India @ 12%

Earned 5% differential interest.

- ➢ What will be your Gain?
- ✓ 1,00,000$ * 74₹ * 5%

  =**3,70,000₹**

But it is not that simple as you think.

By the time when you will repay the loan in US, the price of US Dollar would have increased.

The Interest Rate differential so earned shall be compensated by the exchange loss arising on repayment of US Loan.

◆ Let us determine 1 Year Forward Rate:

Interest Rate Parity Formula

$$\text{Forward Exchange Rate (Fo)} = \text{Spot Exchange Rate (So)} \times \frac{(1 + \text{Interest rate A})^n}{(1 + \text{Interest rate B})^n}$$

Here Interest rate A is 12%

Interest rate B is 7%

n is 1 year

Spot rate is $1=74₹

➢ What will be Forward rate?

✓ **77.458₹**

❖ **At the beginning:**

Amount Borrowed = $1,00,000

+ Interest @ 7% = $7,000

➢ What is total amount payable?

✓ **$1,07,000**

❖ **At the End:**

➢ Total amount payable as per the spot rate:

= $1,07,000*74₹

= **79,18,000₹**

➢ Total amount payable as per forward rate:

= $1,07,000*77.458₹

= **82,88,006₹**

❖ **Excess amount payable due to changes in exchange rate:**

= 82,88,006₹ - 79,18,000₹

= **3,70,006₹**

As per Interest Rate Parity Theory, the resulting exchange loss has completely off-set the gain made through interest rate differential.

(3) Fisher effect

The Fisher Effect is an economic theory created by economist Irving Fisher that describes the relationship between inflation and both real and nominal interest rates.

- According to the Fisher effect:

  Real interest rate = Nominal interest rate - Inflation rate

The result, in practice, is that as inflation rates go up, real interest rate go down, when nominal rates don't increase at rates equal to those of inflation.

For example, if the nominal interest rate on a savings account is 4% and the expected rate of inflation is 3%, then the money in the savings account is really growing at 1%.

The smaller the real interest rate, the longer it will take for savings deposits to grow substantially when observed from a purchasing power perspective.

- Fisher equation:
  - (1+Nominal rate) = (1+Real rate) (1+Inflation rate)
  - (1+i) = (1+r) (1+Pi)

For Example,

Assume that the real interest rate is 5.5% and the rate of inflation changes from 2.5% to 3.5%. The nominal interest rate is calculated as follows:

(1 + Nominal Interest Rate) = (1+Real Interest Rate) (1+Inflation Rate)

- Nominal Interest Rate = (1+0.055) (1+0.025) - 1
  = (1.055) (1.025) - 1
  = **0.081 or 8.1%**

- Nominal Interest Rate = (1+0.055) (1+0.035) - 1
  = (1.055) (1.035) - 1
  = **0.092 or 9.2%**

Therefore, the nominal interest rate would've increased from 8.1% when the inflation rate was 2.5% to 9.2% when the rate of inflation increases to 3.5%.

● Exchange rate arrangements

Exchange rate arrangement is a way a monetary authority of a country or currency union manages the currency about other currencies and the foreign exchange market.

Also known as an **exchange rate regime**.

- There are four major regime types:
  - Floating rate system
  - Pegging of currency
  - Crawling peg
  - Target zone arrangement

(1) Floating rate system

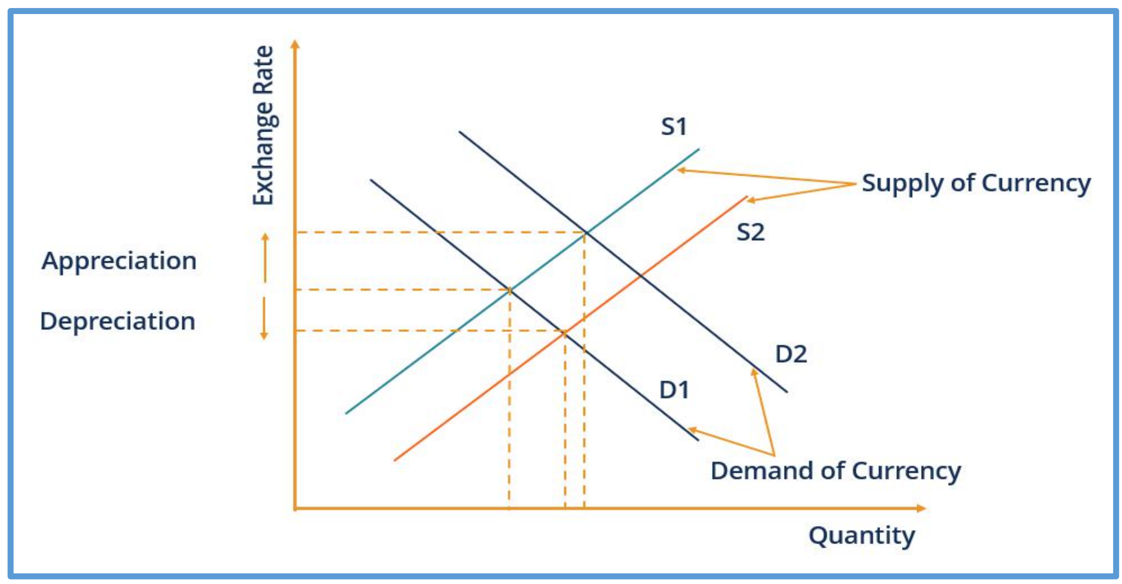
A floating exchange rate is a regime where the currency price of a nation is set by the forex market based on supply and demand relative to other currencies. This is in contrast to a fixed exchange rate.

In a floating rate system, it is the market forces that determine the exchange rate between two currencies.

Floating exchange rate systems mean long-term currency price changes reflect relative economic strength and interest rate differentials between countries.

Short-term moves in a floating exchange rate currency reflect speculation, rumors, disasters, and everyday supply and demand for the currency. If supply outstrips demand that currency will fall, and if demand outstrips supply that currency will rise.

Extreme short-term moves can result in intervention by central banks, even in a floating rate environment. Because of this, while most major global currencies are considered floating, central banks and governments may step in if a nation's currency becomes too high or too low.



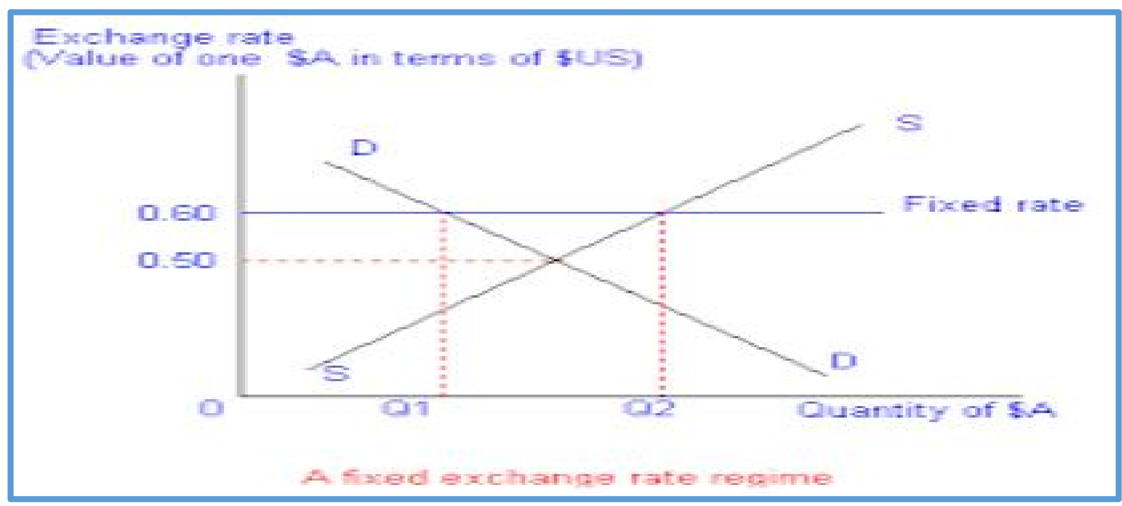
(2) Pegging of currency

Pegging involves fixed exchange rate. A currency can be pegged to: (1) a single currency or (2) basket of currencies.

A currency peg is a policy in which a national government sets a specific fixed exchange rate for its currency with a foreign currency or a basket of currencies.

Pegging a currency stabilizes the exchange rate between countries. Doing so provides long-term predictability of exchange rates for business planning. Pegging involves fixed exchange rate with the result that trade payments are stable.

Normally, a developing country pegs its currency to a strong currency or to a currency with which it conducts a very large part of its trade.

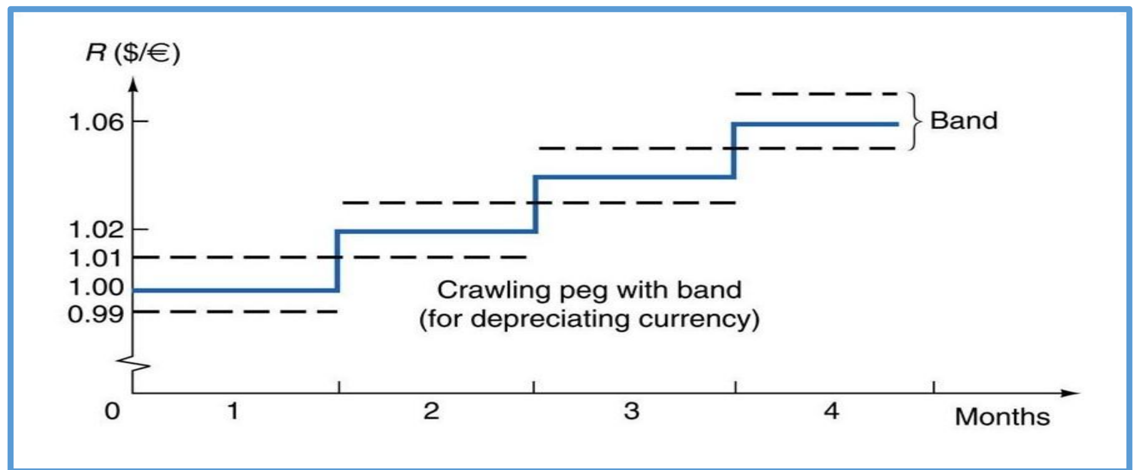


(3) Crawling peg

Crawling peg allows the peg to change gradually over time to catch up with changes in the market determined rates.

It is a hybrid form of fixed rate and flexible rate systems. Hence this system avoids too much of instability and too much of rigidity.

In some of the countries opting for the crawling peg, crawling bands are maintained within which the value of currency is maintained.



(4) Target zone arrangement

Target zone is a sort of monetary union with fixed exchange rate within the union. In a target zone arrangement, the intra-zone exchange rates are fixed.

For example,

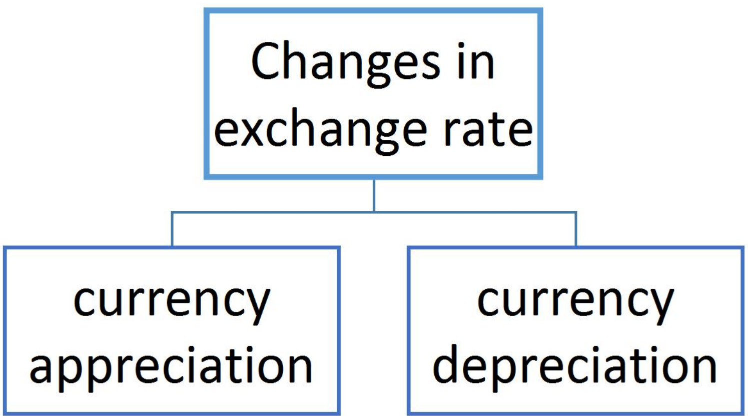
Eastern caribbean currency union

The western african economic and monetary union

Central african economic and monetary community

European union

● Business implications of exchange rate changes



❖ In case of appreciation:

✓ **Export decreases** because foreign country buy less goods from domestic country as now domestic goods seems relatively costly than before.

✓ **Import increases** because domestic country buy more goods from foreign country as now foreign goods are relatively cheaper than before.

✓ **Marketing decisions**

Strengthening of a country's currency value could create problems to exporters. Cost of products and services will be higher in foreign country.

✓ **Production decisions**

companies might locate production in a weak-currency country because low cost of investment and inexpensive exportation.

✓ **Financial decisions**

Can influence the source of financing, cross boarder funds, and reporting financial results.

❖ **<u>In case of currency depreciation</u>**

- ✓ **Export increases** because foreign country buy more goods from domestic country as now domestic goods seems relatively cheaper than before.

- ✓ **Import decreases** because domestic country buy less goods from foreign country as now foreign goods are relatively costly than before.

MODULE 3

CHAPTER 1

COUNTRY EVALUATION

AND

SELECTION

Introduction

An important step in formulating an international marketing strategy is country evaluation and selection, which is the process of opportunity evaluation leading to the selection of foreign markets in which firm will compete.

This process requires an appraisal of the fit between a prospective market's requirements and a company's ability to meet those requirements.

- ➢ When making country selection decisions company must consider:
- ✓ Where to locate sales, production, and administrative and auxiliary services.
- ✓ The sequence for entering different countries.
- ✓ The portion of resources and efforts to allocate to each country where they operate.

❖ Location

In choosing geographic sites, a company must decide:

(1) Where to sell (2) Where to produce

The traditional theory of location suggests that if the inputs account for a large share in the value of a final product, the manufacturing unit should be located near the source of input.

If the raw material carries heavy weight but loses its weight during the manufacturing process, the manufacturing unit should be located near the source of input.

On the other hand, if input does not matter very much, from the viewpoint of cost or transportation, the manufacturing unit should be located near the market.

➢ Factors behind selection of location

- ✓ Size and growth of the market
- ✓ Degree of competition in the market
- ✓ Availability of raw material and skilled labour force
- ✓ State of logistics
- ✓ Degree of currency fluctuation
- ✓ Political and Legal environment
- ✓ Cultural and Linguistic environment

- **Process for country evaluation and selection**
  - ✓ Determine international marketing objectives
  - ✓ Country identification
  - ✓ Preliminary screening
  - ✓ In depth screening/Short listing
  - ✓ Final selection
  - ✓ Onsite visit
  - ✓ Implementation

❖ Scanning

Scanning is useful method for keeping an eye on the functions of the companies across the world. Scanning enables the managers to examine most related countries of the world as a whole and extract the promising opportunities in detail.

Scanning is useful insofar as a company might otherwise consider either too few or too many possibilities. Through the use of scanning, decision makers can perform a detailed analysis of a manageable number of geographic locations.

Scanning aid managers in considering alternatives that might otherwise be overlooked.

❖ How does scanning work

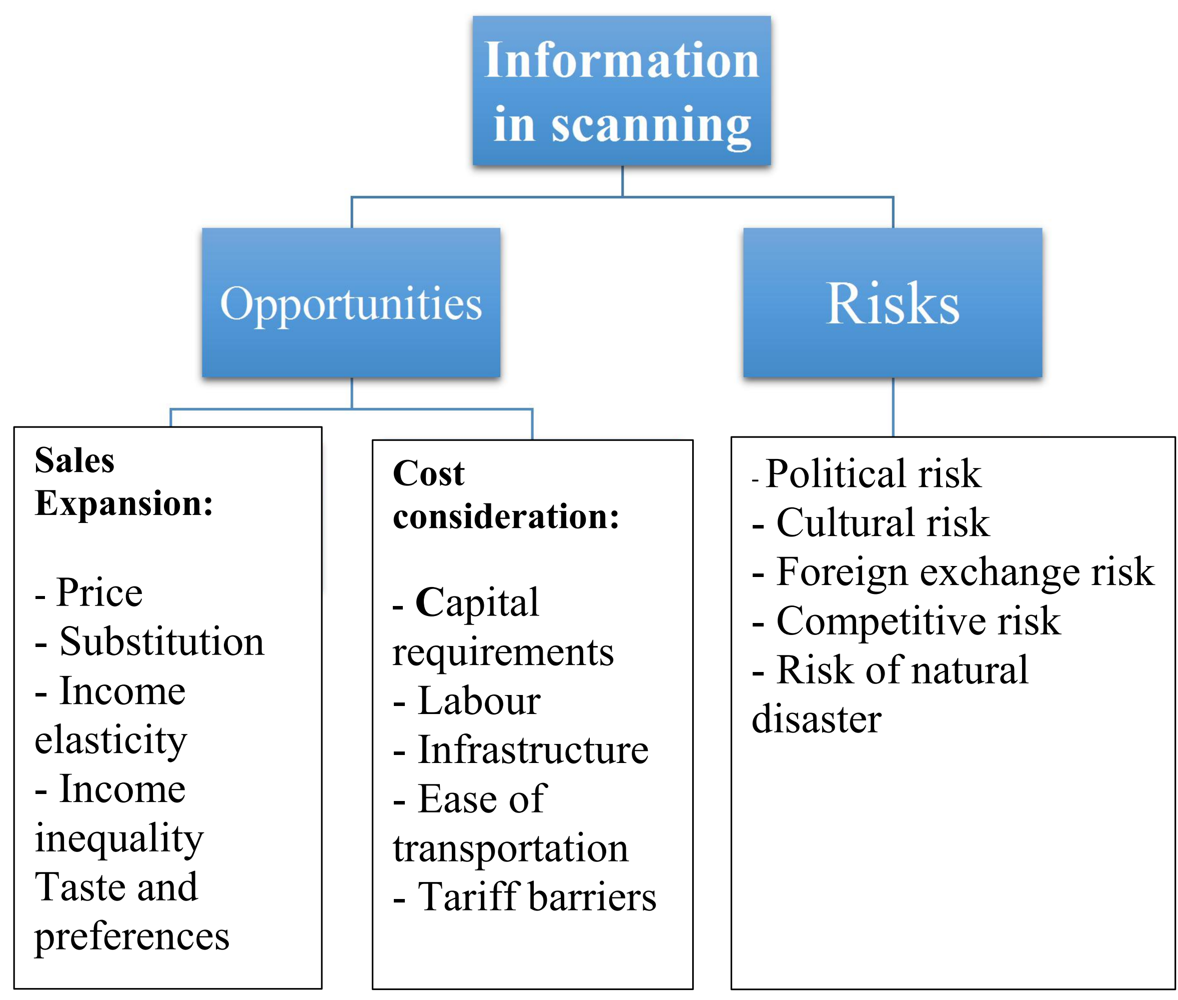
✓ Step - 1: Scanning

Comparing country information that is readily available, inexpensive and fairly comparable.

✓ Step - 2: Onsite visits

- **Information in scanning**

There are several types of information required while assessing a country. But the managers should emphasis more on environmental factors, i.e. the external conditions in a host country that could significantly affect an enterprise's success or failure - exposes both opportunities and risk whose combination should determine what actions to take.



❖ **Opportunities:**

Opportunities for a global company are the life blood to enhance their business. These opportunities are determined by competitiveness and profitability factors available. Variables or information required regarding the opportunity factors considering heavily on the selection of market and production sites would include following:

(1) Sales expansion

1.1 Price

A firm should scan prevailing price levels in different countries while evaluating and selecting country. The relative prices of essential and non-essential good can have a significant impact on consumption patterns. Higher prices for necessary goods have less discretionary income for non-essentials.

1.2 Substitution

While scanning different countries, a firm should scan whether there are any substitutes available for their products in those countries or not. Market having perfect and easy substitution for a company's product can be less favourable while selection.

1.3 Income elasticity

Market potential can be calculated by dividing the percentage of change in product demand by the percentage of change in income in a given country. Income elasticity varies by product and income level, with demand for necessities being less elastic than demand for luxuries.

1.4 Income inequality

While assessing income levels of a countries, a firm should consider the level of income inequalities. Even in areas where per-capita incomes are low, there may be middle and upper income people with substantial income to spend due to income inequality.

1.5 Taste and preference

Countries with similar income levels may exhibit different demand patterns based on differences in cultural values and tastes.

(2) Cost considerations

2.1 Capital requirements

Before selecting any country, a firm should consider total capital requirements for setting up a business in that country.

country having less capital requirements and larger market area is most preferable.

2.2 Labour

While selecting a country, a firm should scan whether the required skilled staff with appropriate knowledge or efficient labour for production purpose will be available in that country or not.

2.3 Infrastructure

Infrastructural facilities like proper transportation facility, storage and warehousing facility, plant and equipment should also be available in the country.

2.4 Ease of transportation

In a country where firm wants to operate, there should be availability of easy transportation facility with lesser costs.

2.5 Tariff barriers

While selecting country for operation, a firm will have to have a knowledge about tariff rules and regulations that a country has imposed on international trade. A country having tariff barriers on a larger scale is less favourable.

❖ Risks

A business risk is a circumstance or factor that may have a negative impact on the operation or profitability of a given company.

Is it ever rational for a firm to invest in a country with high economic and political risk ratings? Such questions must be carefully weighed when making international capital investment decisions.

1. Political risk

Political risk reflects the expectation that political climate in a given country will change in such a way that a firm's operating position will deteriorate.

When evaluating political risk, decision makers refer to past patterns in a given country, expert opinions and country analysts.

2. Cultural risk

Cultural risk refers to the potential for a company's operations in a country to struggle because of differences in language, customs, norms, and customer preferences. The history of business is full of colorful examples of cultural differences undermining companies.

For example, a laundry detergent company was surprised by its poor sales in the Middle East. Executives believed that their product was being skillfully promoted using print advertisements that showed dirty clothing on the left, a box of detergent in the middle, and clean clothing on the right.

A simple and effective message, right? Not exactly. Unlike English and other Western languages, the languages used in the Middle East, such as Hebrew and Arabic, involve reading from right to left. To consumers, the implication of the detergent ads was that the product could be used to take clean clothes and make the dirty. Not surprisingly, few boxes of the detergent were sold before this cultural blunder was discovered.

3. Foreign exchange risk

It refers to the losses that an international financial transaction may incur due to currency fluctuations. Also known as currency risk, FX risk and exchange-rate risk, it describes the possibility that an investment's value may decrease due to changes in the relative value of the involved currencies.

4. Competitive risk

Competitive risk is the chance that competitive forces will prevent you from achieving a goal. It is often associated with the risk of declining business revenue or margins due to the actions of a competitor.

5. Risk of natural disaster

Not only do disasters kill people, damage buildings and disrupt production systems in the impacted countries, but they also create instability in international trade through damages to international trade infrastructure and countries' export and import capacities.

- **<u>Collecting and analyzing data</u>**

➢ **Problems with data**

- ✓ Inaccurate information
- ✓ Non-comparability
- ✓ Limited resources
- ✓ Misleading data
- ✓ Poor research methodology

Firms perform research to reduce uncertainties in their decision processes, to expand or narrow the alternatives they consider and to assess the merits of their programs.

The costs of data collection should always be weighed against the probable pay-offs in terms of revenue gains or cost savings.

- **Country comparison tools**

After collecting information and scanning the possible locations, this is the time to compare the countries by using the various tools and techniques.

Through the process of scanning a collection of relevant data or information is generated, which further needs to be analysed well to extract some essential output.

Companies frequently use several tools to compare opportunities and risk in various countries, such as grids that rate country projects according to a number of separate dimensions and matrices, such as one on which companies plot opportunity on one axis and risk on another.

- **Tools for data analysis**

✓ Market penetration grid

✓ Opportunity-risk analysis

✓ Country attractiveness-company strength matrix

(1) Market penetration grid

- Grids:

  Depicts acceptable or Unacceptable conditions

  Rank countries on important variables

- Matrices:

  Decide on indicators and weight them

  Evaluate each country on the weighted indicators

Variable	Weight	Country I	II	III	IV	V
1. Acceptable (A), Unacceptable (U) factors						
a. Allows 100 percent ownership	–	U	A	A	A	A
b. Allows licensing to majority-owned subsidiary	–	A	A	A	A	A
2. Return (higher number = preferred rating)						
a. Size of investment needed	0–5	–	4	3	3	3
b. Direct costs	0–3	–	3	1	2	2
c. Tax rate	0–2	–	2	1	2	2
d. Market size, present	0–4	–	3	2	4	1
e. Market size, 3–10 years	0–3	–	2	1	3	1
f. Market share, immediate potential, 0–2 years	0–2	–	2	1	2	1
g. Market share, 3–10 years	0–2	–	2	1	2	0
Total			18	10	18	10
3. Risk (lower number = preferred rating)						
a. Market loss, 3–10 years (if no present penetration)	0–4	–	2	1	3	2
b. Exchange problems	0–3	–	0	0	3	3
c. Political-unrest potential	0–3	–	0	1	2	3
d. Business laws, present	0–4	–	1	0	4	3
e. Business laws, 3–10 years	0–2	–	0	1	2	2
Total			3	3	14	13

(2) Opportunity-Risk analysis

Carrying out a cross-country analysis of opportunities and risks provides a useful tool to compare and evaluate various investment locations based on a company's objectives and business environment.

The internationalizing firm may choose variables both for opportunities (such as market size, growth, future potential, tax regime, costs, etc.) and risks (political, economic, legal, operational, etc.).

Values and weights may be assigned to each of these variables depending upon their perceived significance by the firm. Thus, it provides an opportunity to a company to evaluate each country on the weighted indicators.

Exhibit 10.2 Opportunity–risk grid for cross-country evaluation

Variable	Weight	Country			
		A	B	C	D
Opportunities					
▪ Market size					
▪ Growth					
▪ Competitive intensity					
▪ Operations costs					
▪ Marketing efficiency					
▪ Tax rates					
Total					
Risks					
▪ Political					
▪ Commercial					
▪ Economic					
▪ Operational					
Total					

Although, such grids (Exhibit 10.2) serve as useful tools for cross-country comparison of opportunity versus risk, it hardly provides any insight into relationships among the investment destinations.

Countries for investment can also be plotted in form of a matrix, as shown in Fig. 10.23, to indicate opportunities and risks. Besides, the countries can be placed for a pre-defined future time, both for opportunities and risks. In addition to inter-country evaluation, the country placements and its benchmarking with the global average opportunities and risks may also be carried out.

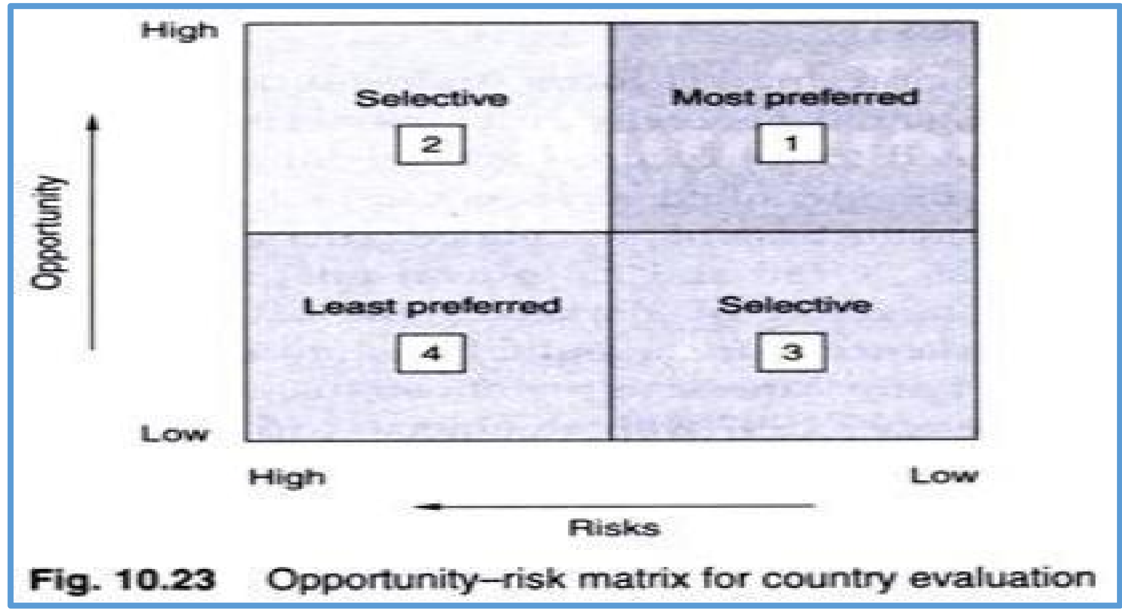


Fig. 10.23 Opportunity–risk matrix for country evaluation

(3) Country attractiveness-company strength matrix

An analysis may be carried out for country evaluation and strategy development based on business attractiveness of countries and the competitive strength of the company.

Various factors, such as market size, market growth, customers' buying power, average trade margins, seasonality and fluctuations in the market, marketing barriers, competitive structures, government regulations, economic and political stability, infrastructure, and psychic distance may be taken into account to assess the country attractiveness.

The competitive strength of a firm is often determined by its market share, familiarity and knowledge about the country, price, product-fit to the market, demands, image, contribution margin, technology position, product quality, financial resources, access to distribution channels, and their quality.

An analysis can be carried out in the form of a matrix, assigning weight to each of these factors. Based on this analysis, a matrix may be drawn as in Fig. 10.25.

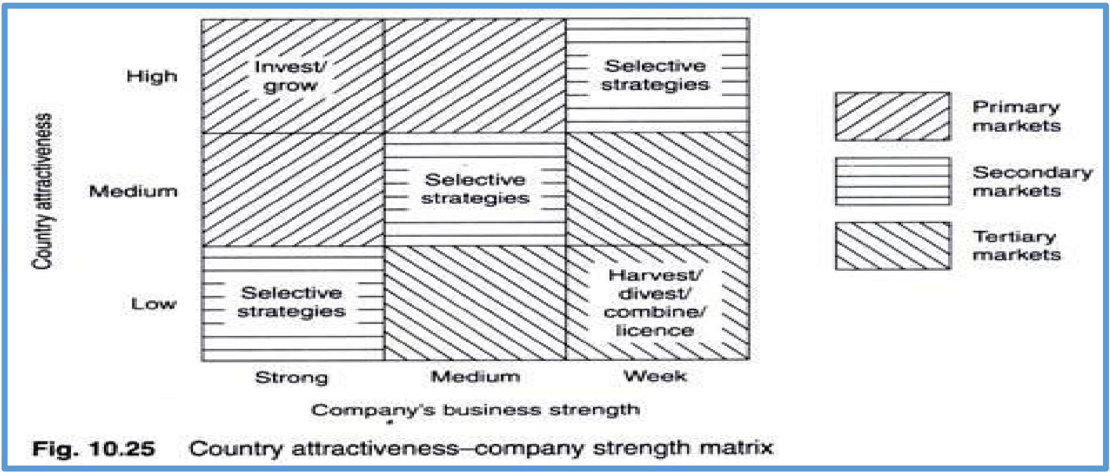


Fig. 10.25 Country attractiveness–company strength matrix

The countries depicted in the matrix may be segmented as

Primary markets:

These countries offer the highest marketing opportunities and call for a high level of business commitments. The firms often strive to establish permanent presence in these countries.

Secondary markets:

In these countries, the perceived political and economic risks are too high to make long-term irrevocable business commitments. A firm has to explore and identify the perceived risk factors or the firm's limitations in these countries and adopt individualized strategies, such as joint ventures so as to take care of the limitations of operating business.

Tertiary markets:

These are countries with high perceived risks; therefore, allocation of firm's resources is minimal. Generally a firm does not have any long-term commitment in such countries and opportunistic business strategies such as licensing are often followed.

Based on the above analysis, a firm should focus its country selection and expansion strategies in countries at the top left of the matrix where the country attractiveness and the competitive strengths of the company are very high. On the other hand, the firm should focus on harvesting/divesting its resources from countries where the country attractiveness and company strength both are very low.

MODULE 3

CHAPTER 3
STRATEGIC FRAMEWORK

● What is strategy

Strategy is a general plan to achieve one or more long-term or overall goals under conditions of uncertainty.

Strategy is defined as the efforts of managers to build and strengthen the company's competitive position within its industry in order to create superior value.

A firm that has operations in more than one country is known as a multinational corporation (MNC).

Multinationals must choose an international strategy to guide their efforts in various countries.

➢ Strategy, Industry and firm

Firm performance is influenced by both the structure of the company's industry and the insight of managers' strategic decision making.

Managers need to be familiar with industry- and firm-level conditions in making strategy.

- ✓ Industry strategy : Porter's Five Forces Model
- ✓ Firm strategy : Value Chain Analysis

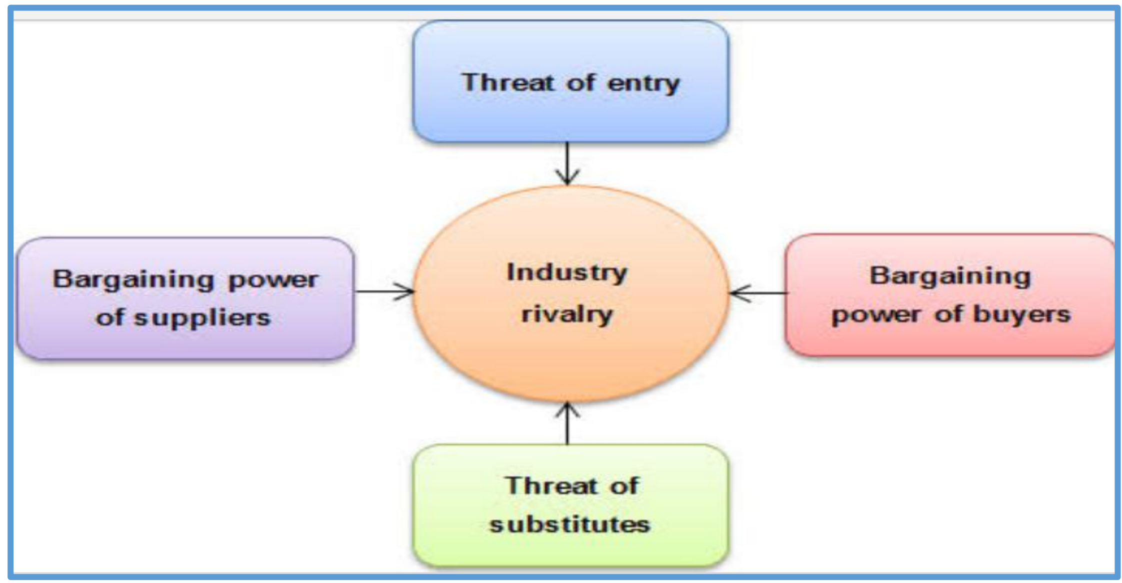
❖ **Porter's Five forces model**

Given by Michael Eugene porter in 1979.

It is tool for analysing competition of a business.

Porter's Five Forces is a model that identifies and analyzes five competitive forces that shape every industry and helps determine an industry's weaknesses and strengths. Five Forces analysis is frequently used to identify an industry's structure to determine corporate strategy.

Porter's model can be applied to any segment of the economy to understand the level of competition within the industry and enhance a company's long-term profitability.



(1) Threat of new entry

A company's power is also affected by the force of new entrants into its market. The less time and money it costs for a competitor to enter a company's market and be an effective competitor, the more an established company's position could be significantly weakened. An industry with strong barriers to entry is ideal for existing companies within that industry since the company would be able to charge higher prices and negotiate better terms.

(2) Bargaining power of suppliers

The next factor in the five forces model addresses how easily suppliers can drive up the cost of inputs. It is affected by the number of suppliers of key inputs of a good or service, how unique these inputs are, and how much it would cost a company to switch to another supplier. The fewer suppliers to an industry, the more a company would depend on a supplier. As a result, the supplier has more power and can drive up input costs and push for other advantages in trade. On the other hand, when there are many suppliers or low switching costs between rival suppliers, a company can keep its input costs lower and enhance its profits.

(3) Bargaining power of buyers

The ability that customers have to drive prices lower or their level of power is one of the five forces. It is affected by how many buyers or customers a company has, how significant each customer is, and how much it would cost a company to find new customers or markets for its output. A smaller and more powerful client base means that each customer has more power to negotiate for lower prices and better deals. A company that has many, smaller, independent customers will have an easier time charging higher prices to increase profitability.

(4) Threat of substitutes

Substitute goods or services that can be used in place of a company's products or services pose a threat. Companies that produce goods or services for which there are no close substitutes will have more power to increase prices and lock in favorable terms. When close substitutes are available, customers will have the option to forgo buying a company's product, and a company's power can be weakened.

(5) Industry rivalry

The larger the number of competitors, along with the number of equivalent products and services they offer, the lesser the power of a company. Suppliers and buyers seek out a company's competition if they are able to offer a better deal or lower prices. Conversely, when competitive rivalry is low, a company has greater power to charge higher prices and set the terms of deals to achieve higher sales and profits.

- Understanding Porter's Five Forces and how they apply to an industry, can enable a company to adjust its business strategy to better use its resources to generate higher earnings for its investors.

❖ **<u>Value chain analysis</u>**

The concept was given by Harvard Business Professor Michael Porter in his book "The competitive Advantage: Creating and Sustaining Superior Performance".

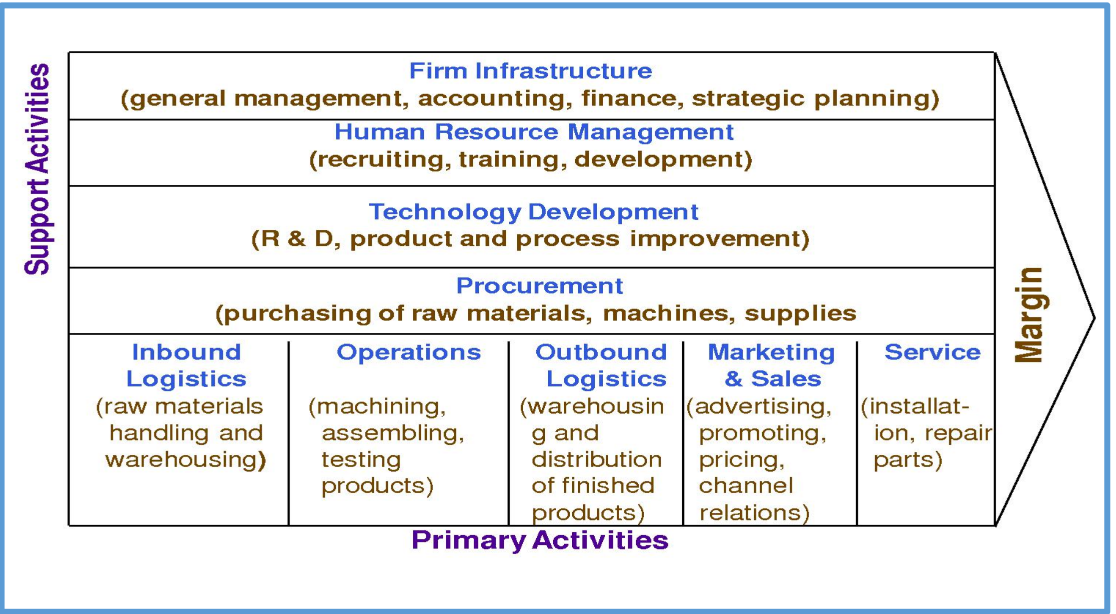
Value chain:

Set of linked value creating activities that company perform to design, produce, market, deliver and support a product.

Value chain analysis:

Chain of activities through which organisation provide value to its customers.

Helps the manager to understand the behaviour of costs and the existing and potential sources of differentiation.



COMPONENTS OF A VALUE CHAIN

According to Porter's definition, all of the activities that make up a firm's value chain can be split into two categories that contribute to its margin: primary activities and support activities.

- **Primary activities** are those that go directly into the creation of a product or the execution of a service, including:

Inbound logistics

Activities related to receiving, warehousing, and inventory management of source materials and components

Operations

Activities related to turning raw materials and components into a finished product

Outbound logistics

Activities related to distribution, including packaging, sorting, and shipping

Marketing and sales

Activities related to the marketing and sale of a product or service, including promotion, advertising, and pricing strategy

After-sales services

Activities that take place after a sale has been finalized, including installation, training, quality assurance, repair, and customer service

Secondary activities help primary activities become more efficient—effectively creating a competitive advantage—and are broken down into:

Procurement

Activities related to the sourcing of raw materials, components, equipment, and services

Technological development

Activities related to research and development, including product design, market research, and process development

Human resources management

Activities related to the recruitment, hiring, training, development, retention, and compensation of employees

Infrastructure

Activities related to the company's overhead and management, including financing and planning.

● Global Integration v/s Local Responsiveness

The Bartlett & Ghoshal Model indicates the strategic options for businesses wanting to manage their international operations.

This is a model that tries to explain how organisations can succeed in international markets.

- When it comes to International Business, organisation faces two types of pressure:
  - ✓ Global Integration
  - ✓ Local Responsiveness

- This model explains four types of strategies:
  - ✓ International strategy
  - ✓ Multidomestic strategy
  - ✓ Global strategy
  - ✓ Transnational strategy

Global integration is the degree to which the company is able to use the same products and methods in other countries.

Local responsiveness is the degree to which the company must customize their products and methods to meet conditions in other country.

The Bartlett & Ghoshal Matrix

	LOW PRESSURE FOR LOCAL RESPONSIVENESS	HIGH PRESSURE FOR LOCAL RESPONSIVENESS
HIGH PRESSURE FOR GLOBAL INTEGRATION	Global	Transnational
LOW PRESSURE FOR GLOBAL INTEGRATION	International	Multi-domestic

(1) International strategy

Opportunistic expansion into foreign operations that leverages the firm’s core (domestic) competencies.

Ultimate control and decision-making reside at headquarters.

Value is created by transferring core competencies and unique offerings from headquarters into foreign markets where rivals are unable to develop, match, or sustain them.

International activities are generally secondary to the priorities of the domestic market.

Headquarters's ethnocentric orientation, i.e., its home country focus, may lead to significant missed market opportunities.

Also known as Export strategy.

(2) Multidomestic strategy

Expansion into foreign operations that grants decision-making authority to local managers and emphasizes responsiveness to local conditions.

Decision-making is decentralized so that offerings can be adjusted to meet the needs of individual countries or regions.

Value is created by giving local managers the authority to respond to unique local cultural, legal, and economic environments.

The polycentric view holds that people who are close to the market both physically and culturally can best run a business.

The distribution of decision-making authority to local managers may lead to duplication in activities and significantly higher costs.

(3) Global strategy

Expansion into foreign operations that champions worldwide consistency, standardization, and cost competitiveness.

Although activities are dispersed to the most favorable global locations, decision-making remains highly centralized at headquarters.

Value is created by designing products for a world market and manufacturing and marketing them as effectively and efficiently as possible.

Global firms strive to convert global efficiency into price competitiveness via production and location economies.

In markets where demand for local responsiveness remains high, global strategies are largely ineffective, and market opportunities are missed.

Also known as Standardization strategy.

(4) Transnational strategy

Expansion into foreign operations that exploits location economies, leverages core competencies, and responds to key local conditions.

The causes of interactive global learning and worldwide information sharing are championed.

Value is created by the exchange of ideas, products, and processes across functions and borders.

The transnational MNE differentiates capabilities and contributions while finding ways to systematically learn and ultimately integrate and diffuse knowledge, thus developing more powerful core competencies.

Realistically, the transnational firm faces serious challenges to its attempts to efficiently and effectively configure and coordinate its activities.

Company	International	Multinational	Global	Transnational
Strategy	International	Multi Domestic	Global	Global
Model	Coordinated	Decentralized	Centralized	Integrated
Views of the World	Extension Markets	National Markets	Global Markets	Global Markets and Resources
Approach	Ethnocentric	Polycentric	Mixed	Geocentric
Knowledge	Retain within operation units	Retain within operation units	Shared and jointly marketing developed	All functions work as joint
Role of Country	Adopting and leveraging competencies	Exploit local opportunities	Marketing or sourcing	Worldwide contributions of all functions
Key Assets	Centralized	Self sufficient	All in home country	Interdependent

MODULE 3

CHAPTER 4

INTERNATIONAL ORGANISATIONAL STRUCTURE

- **Organisation Structure**

An organizational structure is a system that outlines how certain activities are directed in order to achieve the goals of an organization.

These activities can include rules, roles, and responsibilities.

The organizational structure also determines how information flows between levels within the company.

Having an organizational structure in place allows companies to remain efficient and focused.

- **Organisational structure for International Business**

✓ Export structure

✓ International division structure

✓ Global division structure

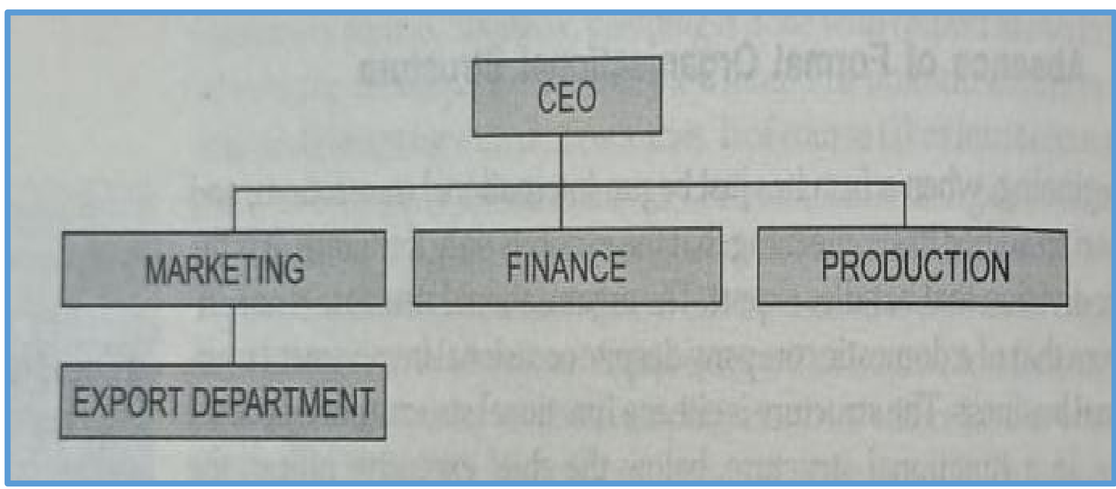
✓ Multidimensional/Matrix structure

(1) Export structure

The organisational structure changes the moment the firm begins exporting on a continuous basis.

In such cases, the firm may set up an export department as a sub-department of marketing.

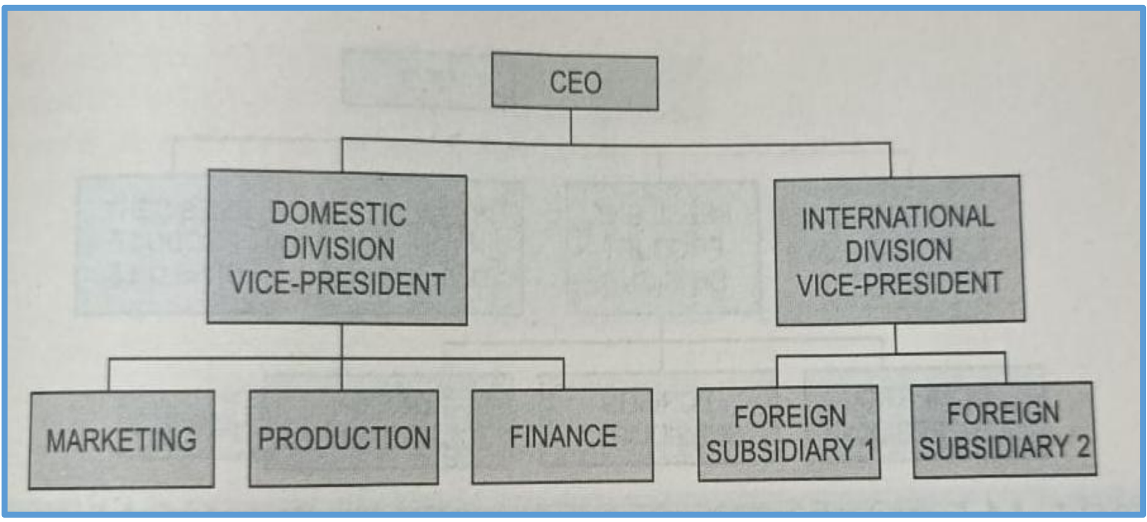
Priority in this type of organisation is mainly the domestic market, rather than on the foreign market, with the result that the domestic marketing department maintains an overall control over the export department.



(2) International division structure

With exports moving on to a stronger footing and sometimes with growing competition for the same market, the firm's attitude towards the organisational structure changes and it sets up an independent functional division i.e. international division.

It may be a part of the firm; or may be incorporated as a separate entity, depending upon how the objectives of the firm are accomplished more easily.



(3) Global division structure

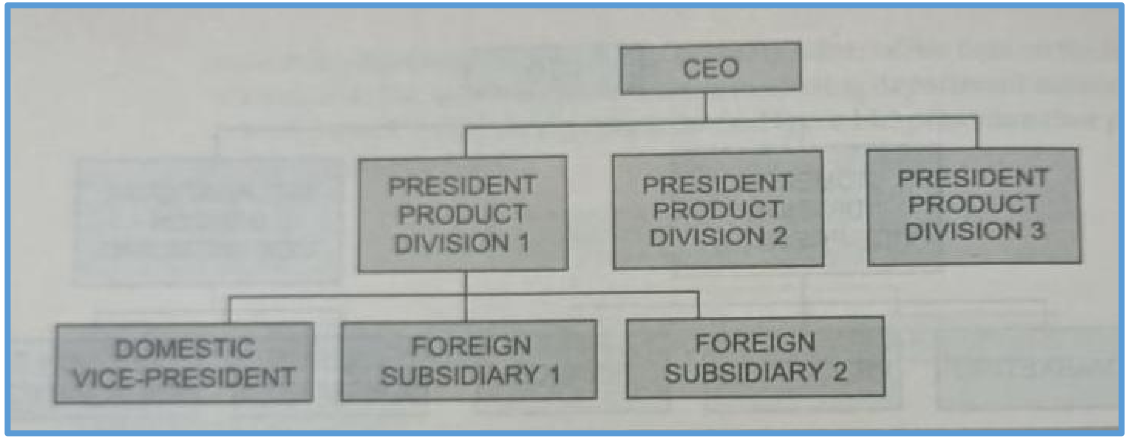
Global structure is customer oriented, where worldwide customers are segmented into different classes and firm's operations are structured accordingly.

- ➢ Global division structure can be of three types:
- ✓ Global product structure
- ✓ Global area structure
- ✓ Global functional structure

- ➢ **Global product structure**

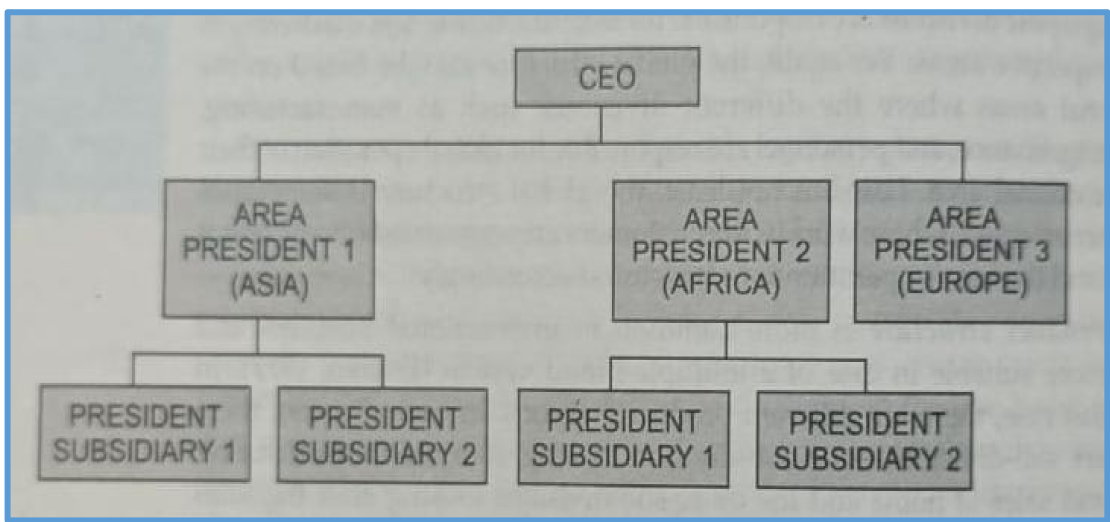
There are different product divisions in this case.

In each division, there are sub divisions. one sub division looking after the manufacturing and sales at domestic country and the other sub divisions looking after the sales of foreign countries.



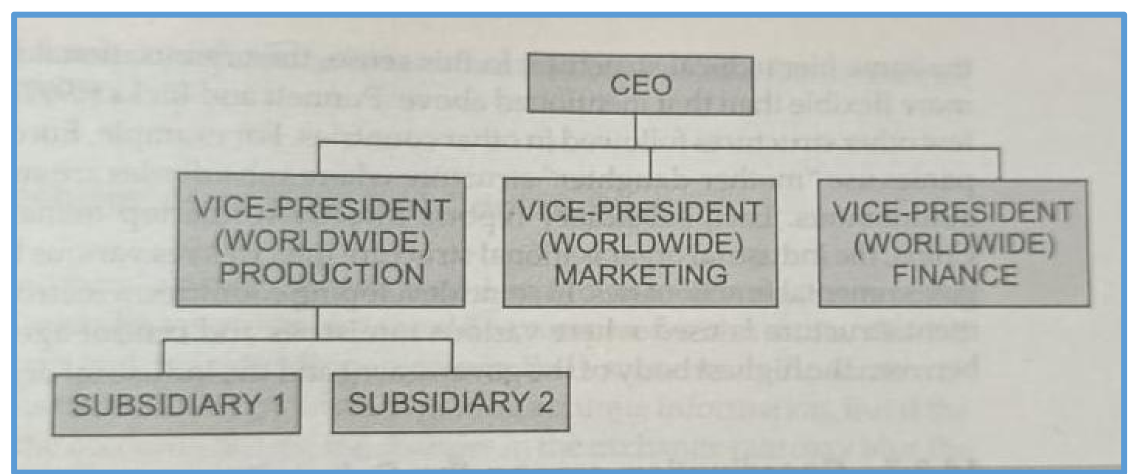
- **Global area structure**

In case of area structure, organisation is based on the geographic areas and operations are divided accordingly.



- **Global functional structure**

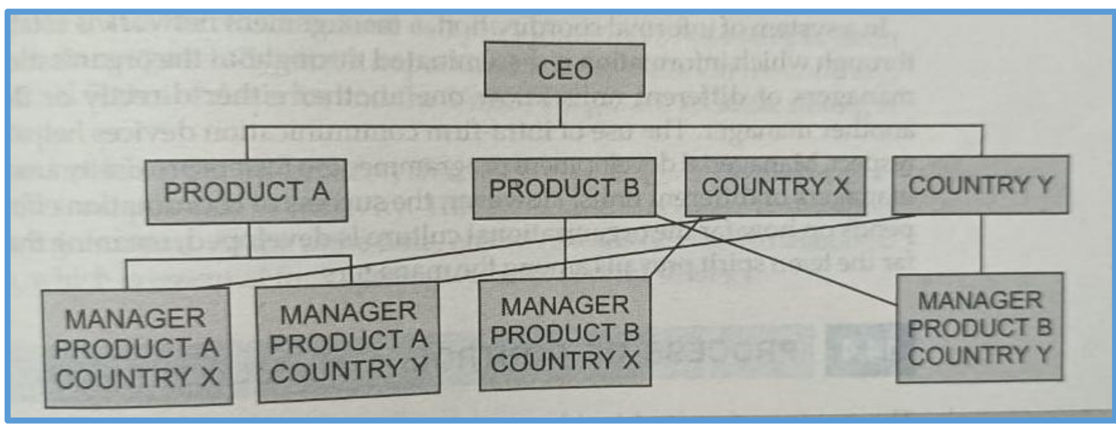
The functional structure emphasis on specific functions such as manufacturing, marketing, finance and so on.



(4) Multidimensional/Matrix structure

Matrix structure is a combination of product, area and functional structures.

A firm reaches this particular stage when economies of scale in production reaches new high and different subsidiaries are able to expand their market beyond their traditional domain.



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YOU!

MBA SEMESTER 3

INTERNATIONAL BUSINESS

(4539281)

MODULE 4

CHAPTER 1

MARKETING GLOBALLY

● Introduction

Global marketing involves planning, producing, placing, and promoting a business' products or services in the worldwide market. It is the process of conceptualizing and subsequently conveying a final product or service globally. The company aims to reach the international marketing community.

Global marketing is defined as the marketing activity which is carried out across the national boundaries. Hence, it involves the process of marketing the goods and services from one nation to another nation.

A company can market its products in more than one at a time. One should not misunderstand global marketing as international trade. Global marketing is just a part of international trade.

- **Marketing strategies**

A marketing strategy refers to a business's overall game plan for reaching prospective consumers and turning them into customers of their products or services.

A marketing strategy contains the company’s value proposition, key brand messaging, data on target customer demographics, and other high-level elements.

The strategy of marketing deserves far greater attention in international business than in case of domestic business.

This is because consumers are widely spread over a number of countries.

Market identification and demand estimation

The marketing strategy in international business begins with the identification of the market and estimation of the demand potential.

Selection of market

The first step in the marketing strategy is to identify the potential market on which the firm has to emphasis. It is because particular product cannot necessarily be demanded in all markets. Thus, in very beginning, the firm has to identify the countries where the product can be marketed.

Estimation of Demand

After the identification of the markets, it is necessary to estimate the size of the total demand in a particular market and the possible share of the firm's own product.

Market concentration v/s Market diversification

Market concentration strategy means that the focus of marketing activities is confined to a smaller area. This strategy is based on focusing on a particular market. On the contrary, the market activities are spread over a large area is a market diversification strategy. This strategy involves wider coverage of markets.

Where the product is standardized or where the different markets experience stable growth in demand, market diversification strategy is the suitable option.

After the market is identified and the demand is estimated, the next step is to reach the market with appropriate products, a appropriate prices, and through effective channel of distribution.

If actual sales tend to lag behind potential sales, the firm adopts a variety of promotional activities.

- A thorough marketing strategy covers "the four Ps" of marketing:

- ✓ Product
- ✓ Price
- ✓ Place
- ✓ Promotion

● Product strategy

➢ Standardization versus adaptation

At the very core of the product strategy lies a crucial decision regarding whether the product to be marketed should be standard product or it should be an adapted product.

Product standardization refers to homogeneous features of a product for all markets.

Adaptation means that the product undergoes modification for different markets.

➢ Advantages of standardized product

- ✓ It is easier to achieve economies of scale when product is standardized.
- ✓ Economies of scale in turn lead to greater profits.
- ✓ When consistency in product image is required, standardization is useful.
- ✓ In case of some high-technology products, both the manufacturers and the users prefer to encourage compatibility through industry specifications and, to this end, standardization is useful.

➢ Factors behind adaptation

There are lots of factors leading to the adaptation of products. Some of the factors are mandatory, while the others are optional. A particular factor is treated as mandatory if it does not allow a product to enter a market.

Managers must consider the legal requirements and redesign the product accordingly. On the contrary, local use conditions, space constraints, environmental characteristics, income level of consumers, and so on are the optional factors.

However, here these factors are grouped as following:

- ✓ Related to the features of the product
- ✓ Related to the features of a particular market
- ✓ Related to firm’s own decision

(1) Product features

- **Brand name:**

Branding, which creates identification for the product and helps ensure a minimum level of quality, is one of the most important factors related to product characteristics.

It is a fact that a single brand throughout different markets boosts up the image of the product in question, reduces the advertising cost, and provides convenient identification.

For example, Bata shoes are marketed in over 90 countries under a single brand name.

But when a firm is unable to ensure uniform product quality across countries, it prefers multiple branding- different brands for different markets.

For example, Close up toothpaste did well in thailand when the brand name was translated as Klai chid.

- **Technical features:**

The technical features of the product must be consistent with the product specifications in different markets.

For example, Electrical appliances in USA should conform 110 volts, while they should conform to 220 volts in Europe and many other countries.

- **Packaging and labelling:**

Packaging and labelling requirements differ among different products. Owing to longer channels of distribution in international business, especially for a distantly located market, there is special packaging for food or perishable products is required.

(2) Market features

- **Governmental regulations:**

The most important factor influencing market features is governmental regulations.

For example, European Union countries have spelled out specific standards for more than 10,000 products. If international firms have to market their products in this area, they have to modify their product according to the set standards.

- **Consumer's characteristics:**

It is the attitude, taste, social behaviour, and educational level of the consumer in a particular market that influences the demand for the particular product.

For example, Brazilians seldom eat breakfast at home. In order to suit their taste, Dunkin' donuts sells doughnuts as snacks, and that too with local fruit fillings.

- **Income level:**

The income level in different markets is normally different and so is the consumption pattern. In a low-income developing country, consumers go for the price and not necessarily for the quality of the goods.

For example, Singer sells simple a hand powered sewing machine in Africa.

(3) Firm's own decisions:

Even if the features of the product or market are in favour of modification, the modification strategy is adopted only when it adds up to the profitability of the firm.

Before any modification is attempted, the firm analyses its impact on profitability; it compares the cost of modification with the cost of lost sales on account of no modification.

For example, Whirlpool uses the same basic compressor for refrigerators for all markets, but make changes in doors for different markets.

- **Pricing strategy**

(1) Price discrimination

It is because demand conditions vary among countries and among different segments of consumers in a particular country, a multinational firm charges different prices for the same product in different markets or in different segments of a particular market.

This practice is known as price discrimination. It helps firms to maximize profits.

(2) Skimming price v/s Penetration price

Charging a higher price in the beginning followed by lower prices later is price skimming.

Entering the market by lower price in order to attract the consumers followed by a higher price, is known as penetration price strategy.

(3) Bundling / Unbundling of product

If the prices based on cost are very high in the international market, they can be moderated at least to some extent through different devices. Unbundling of product is one such device.

Bundling of the product carries greater price for the product but accessories add only little value to the product.

Unbundling refers to the low prices for bare-bone product, so it seems very lucrative for the buyer; but accessories are priced very high.

(4) Dumping

Dumping means selling the product in international market at a lower price than in the domestic market.

Lower international prices than the domestic market prices, either to clear distressed stock or to throw the competitors out of market.

● Selecting channel of distribution

The marketing strategy also involves the selection of a suitable channel of distribution that proves most effective and involves the least cost. The channel of distribution may be direct or indirect.

➢ Direct and indirect channels

- ✓ In a **direct channel**, the firm deals directly with a foreign firm without going through any domestic intermediary and export goods through its own internal organisation.

The manufacturer may appoint a foreign distributor which is usually known as an importer or a foreign wholesaler.

It may use a foreign retailer or it may export directly to a state owned trading company.

- ✓ In **Indirect channel,** on the other hand, the manufacturer need not correspond with the foreign party abroad. It involves rather intermediary that may be either domestic agent or domestic merchant.

Indirect channel involves an intermediary such as export broker, export agent, export vendor, export merchant etc.

- **Suitability of the channel**

Direct and indirect channels- both of them have their merits and demerits. The firm needs to select a particular channel or a mix of channels.

In fact, the decision depends upon the product, features of the channels, various factors operating in different markets, and the firm's overall strategy of market of market penetration and market control.

Different channels have different features. A prticular channel is adapted by a firm when its features suit its own interest.

For example, export agents are preferable where the market is widely spread.

- **Adaptability of the channel**

Related to the question of suitability of distribution channel, is the issue of adaptability of the channel.

It is important to decide whether the firm should adapt a single channel throughout its entire market or it should adapt channels according to the needs of the different markets.

- **Promotion strategy**

When actual demand for the product lags behind its potential demand, it simply means that the firm is not able to communicate the consumers effectively about the features and usefulness of the product.

It is then necessary to ensure effective communication through right media suiting consumers' attitude and belief structure.

- **Modes of sales promotion**
  - ✓ Personal selling
  - ✓ Advertisement
  - ✓ Publicity

(1) Personal selling

In case of personal selling, the sales representatives come closer to the consumers and are able to develop a sense of confidence in the minds of the latter.

This mode is more effective when the sale and purchase is infrequent and when the market is concentrated where the product carries a high value.

(2) Advertisement

The superiority of a product over similar products is displayed through newspaper, television and many other means such as radio, magazines, cinema etc.

Advertising occupies the most significant place in sales promotion strategy.

However, the success of advertising depends upon when and how much media time and space is available.

(3) Publicity

Publicity is effected through media, but unlike advertisement, it is not paid for by the sponsors.

In order to illustrate, one can quote that Nike distributing shoes to professional athletes and thereby gaining additional exposure when the teams appeared on television.

- **The Push-Pull Mix**

Promotion may be categorized as push, which uses direct selling techniques, or pull, which relies on mass media.

For each product in each country, a company must determine its promotional budget as well as the mix between push and pull.

MODULE 4

CHAPTER 2

INTERNATIONAL HRM

● Introduction

International Human Resource Management (IHRM) is the term used for organisations that manage their human resources activities at an international level. IHRM includes 'typical' HR functions such as recruitment, selection, performance management, training and development, and remuneration, however these are analyzed and/or managed at an international level.

When human resource management assumes a global perspective, it becomes International Human Resource Management or Cross-cultural human resource management.

It is the process of sourcing, allocating and effectively utilising human resources in a multinational organisation.

● Definition

➢ According to Scullion,

"IHRM has been defined as the HRM issues and problems arising from the internationalization of business; and the HRM strategies, policies and practices which firms pursue in response to the internationalization process."

- **Strategic functions of IHRM**
  - ✓ Human Resource Planning
  - ✓ Recruitment and Selection
  - ✓ Training and Development
  - ✓ Remuneration
  - ✓ Performance Management
  - ✓ Employee Retention

- **Challenges of IHRM**
  - ✓ Managing cultural diversity
  - ✓ Managing complexity of workforce
  - ✓ Managing resistance to change
  - ✓ Management of communication channels
  - ✓ Management of divergent economic systems
  - ✓ Management of legal and industrial relations issues
  - ✓ Managing HR perception across across countries

- **Expatriates**

Expatriates, also called "international assignees", are employees that are non-citizens of the country in which they are working.

Expatriate is the term often used in the context of professionals stationed abroad by their companies, as opposed to locally hired staff.

- **Definition**

➢ According to Aycan and Kartungo,

"Expatriates can be defined as the employees of business and government organisations who are sent by their organisation to a related unit in a country which is different from their own, to accomplish a job or organisation-related goal for a pre-designed temporary time."

- **Types of expatriates**

✓ PCNs

✓ TCNs

(1) Parent Country Nationals (PCNs)

Parent country nationals are also called as home country nationals, are citizens of the country where the company is headquartered who are assigned to one of its foreign operations.

For example, if a German multinational selected a German manager to go to Bolivia, he or she would be a home country national.

- **Advantages of PCNs**
  - ✓ Familiarity with the home office's goals, objectives, policies and practices
  - ✓ Technical and managerial competence
  - ✓ Effective liaison and communication with home-office personnel
  - ✓ Easier exercise of control over the subsidiary's operations

- **Disadvantages of PCNs**
  - ✓ Difficulties in adapting to the foreign language and socio-economic, political, cultural, and legal environment
  - ✓ Excessive cost of selecting, training, and maintaining expatriate managers and their families abroad

- ✓ The host country's insistence on localising operations and on promoting local nationals in top positions at foreign subsidiaries
- ✓ Family adjustment problems, especially concerning the unemployed partners of managers

(2) Third Country Nationals (TCNs)

Third country nationals are employees of a firm who are citizens of neither the country where the firm is headquartered nor the foreign operations where they are assigned.

For example, if a German multinational hired a French mining engineer for the assignment in Bolivia, he or she would be a third country national.

- **Advantages of TCNs**
  - ✓ Perhaps the best compromise between securing needed technical and managerial expertise and adapting to a foreign socio-economic and cultural environment
  - ✓ TCNs are usually career international business mangers
  - ✓ TCNs are usually less expensive to maintain than PCN
  - ✓ TCNs may be better informed about the host environment than PCNs

- **Disadvantages of TCNs**
  - ✓ Host country's sensitivity with respect to nationals of specific countries
  - ✓ Local nationals are impeded in their efforts to upgrade their own ranks and assume responsible positions in the multinational subsidiaries

- **Benefits of using Expactriate**

(1) Enhanced operational control and coordination

International assignments can help companies coordinate and control operations that are widely dispersed geographically or culturally.

(2) Increased information gathering

When the managers spend two or three years in one location and understand the local culture and customs can provide strategic information for both managers and their companies.

(3) Managerial skills development

International assignments can help managers develop new skills for working with both colleagues and customers around the world.

- **<u>Expatriate failure</u>**

Failure for expatriates is often defined as the premature return of an expatriate i.e. return home before the assignment is completed.

➢ **Reasons for expatriate failure**

- ✓ Inability of spouse/partner to adjust
- ✓ Personal inability of assignee to adjust
- ✓ Lack of support from family or other family problems
- ✓ Failure in expatriate selection
- ✓ Expatriate's inability to cope with larger responsibility of overseas work
- ✓ Lack of technical competence
- ✓ Lack of motivation
- ✓ Dissatisfaction with quality of life in foreign location
- ✓ Dissatisfaction with compensation and benefits
- ✓ Critical cause for expatriate failure is the "soft issue" - impact of culture

➢ Managing expatriate failure

One of the problems contrasting IHR professional is to manage the expatriate failure rate. Below given points are guidelines that would help to minimise expatriate failure.

(1) Clear job descriptions

Design a job that maximises role clarity, minimises role conflict and compensates for role novelty with a proper selection of a candidate with a high level of international experience.

(2) Clear cut measures of selection

Use discerning measures for selection of international employees and their companions.

(3) Coordination

Educate native and foreign employees in intercultural communication competence.

(4) Training

Provide opportunity for language lessons.

(5) Technical assistance

Provide a technical assistant to help with the details of starting life in a different culture.

(6) Providing information

Provide all information and equipment pertinent to the role/work of the employees.

(7) Problem sharing

Create open, frequent communication with the home organisation with the home organisation to dispel feelings of abandonment and to ensure a favourable position upon returning.

(8) Social gatherings and interactions

Create opportunities for positive social interactions in order to communicate and become better acquainted with host country members and with other people in the same situation.

(9) Feedback

Regular feedback should be taken to know the problems if any.

(10) Organisational support

Provide proper organisational support systems, both through logistical support and support from supervisors and co-workers in the host country.

(11) Considering spouse

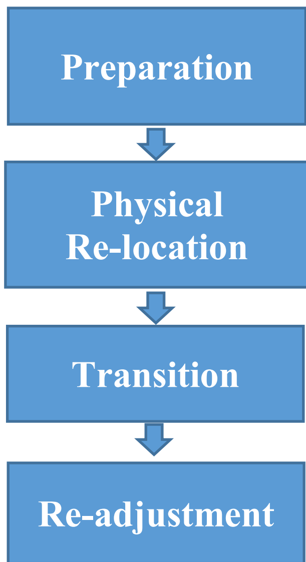
Include spouse in any training and support programs.

- **<u>Repatriation of expatriates</u>**

Repatriates are those employees who return back to the parent country after their international assignments.

Repatriation is also known as 'home coming' or 're-entry'.

- **<u>Process of repatriation</u>**



MODULE 4

CHAPTER 3

GLOBAL MANUFACTURING

- **Introduction**

International manufacturing management provides an unparalleled opportunity for companies to grow into new markets while at the same time boosting their competitiveness.

A Global Manufacturer is a company that manufactures components, sub-assemblies, assemblies, and finished products by leveraging raw material, manufacturing capabilities, cost, and an efficient supply chain that spans across the world.

The primary reason manufacturing companies take production overseas is to reduce overhead, production, and tooling costs. For example, while raw materials cost about the same in China as they do anywhere else in the world, manufacturers can offset material costs with China's comparatively low labor costs.

● Decisions concerning global manufacturing

When an international company possesses a particular technology and decides to begin maufacturing, it needs to adopt a sound operations strategy so as to enjoy a competitive advantage.

(1) Manufacturing location decision

There are two basic strategies for locating manufacturing facilities:

- Concentrating them in a centralised location and serving the world market from there.
- Decentralising them in various regional or national locations that are close to major markets.

(2) Inventory management decisions

When raw materials, intermediate goods, or finished products must be transported over long distances - particularly by ocean shipping - there will inevitably be more delays, confusion, damage, theft and other difficulties than occur in a one-country operation.

In that case manager is less concerned about ordering the economically optimal quantity of inventory and making sure that sufficient quantity of inventory are delivered when needed.

- There are two options available to organisation related to inventory management decisions:
  - ✓ Lean manufacturing
  - ✓ Just-in-time systems

(3) Sourcing decisions

Global sourcing occurs when buyers purchase goods and/or services from sellers located anywhere in the world.

- There are four modes of international sourcing:
  - ✓ Import
  - ✓ Establishment of international procurement offices
  - ✓ Sourcing through direct investment
  - ✓ Strategic alliance

(4) Make or Buy decision

What could be outsourced is examined and decided by the make-or-buy decisions.

- The make or buy decision relates to two aspects:
  - ✓ What tasks and functions should be performed within the firm and which one should be sourced to outside.
  - ✓ What type of relationship should be developed with the supplying companies for the activities it outsources to other firms.

- ## Global Supply Chain Management

Supply chain refers to the coordination of materials, information, and funds from the initial raw material supplier to the ultimate customer.

Firms need to continuously find new ways for improving their products or services and minimising costs in order to acquire competitive edge in the international business environment.

This implies that more consideration has to be given on the effectiveness and efficiency of supply chain under a global market setting.

- ### Globalisation approaches and supply chain strategy

There is no single “best” approach to global supply chain management.

A firm’s global supply chain strategy will differ based on the approach to globalisation adopted by the firm.

(1) Multinational firm

The multinational firm may manage independent domestic supply chains in multiple countries, in which case the firm may rely on local managers, suppliers, and transporters and is not faced with cross-border movements and multiple currencies.

(2) International firm

International firm may manage imports and exports across national borders, or local supply chains in multiple countries, with supply chain knowledge and expertise maintained in corporate headquarters in the home country.

(3) Global firm

A Global company may manage supply chains across multiple national borders, operating in an integrated global environment and managing a global network of supply and demand.

(4) Transnational firm

The Transnational firm is selective in managing supply chain activities both globally and locally, taking advantage of global scale where appropriate while establishing local management and responsiveness where appropriate.

● Supplier Networks

(1) Outsourcing

Domestic sourcing allows the company to avoid problems related to:

- ✓ Language
- ✓ Culture
- ✓ Currency
- ✓ tariffs, and so forth

Foreign sourcing allows the company to reduce costs and improve quality, among other things.

(2) Supplier relations

When a company sources parts from suppliers around the world, distance, time, and the uncertainty of the international political and economic environment can make it difficult for managers to manage inventory flows accurately.

(3) Transportation network

The transportation system links together suppliers, companies and customers.

Foreign trade zones (FTZs) - special locations for storing domestic and imported inventory in order to avoid paying duties until the inventory is used in production or sold.

MODULE 4

CHAPTER 4

CORPORATE GOVERNANCE AND CORPORATE SOCIAL RESPONSIBILITY

CORPORATE GOVERNANCE

● Introduction

Corporate governance is the combination of rules, processes or laws by which businesses are operated, regulated or controlled.

The term encompasses the internal and external factors that affect the interests of a company's stakeholders, including shareholders, customers, suppliers, government regulators and management.

Governance systems are not uniform across countries.

They are shaped by a variety of factors that are inherent to the business environment:

- ✓ Efficiency of local capital markets
- ✓ Protections afforded by legal system
- ✓ Reliability of accounting standards
- ✓ Enforcement of regulations
- ✓ Societal and cultural values

CG in International context

- ✓ The United States
- ✓ The United Kingdom
- ✓ Japan
- ✓ China
- ✓ India

(1) The United States

- Large and liquid capital markets; active market for corporate control.

- Investor interests protected by the Securities and Exchange Commission.

- Accounting standards defined by professional body (FASB).

- Governance standards established by:
  - ✓ Exchange listings (NYSE, NASDAQ).
  - ✓ Legislation (Sarbanes Oxley, Dodd Frank).

- Mostly shareholder centric.

(2) The United Kingdom

- Similar to the United States (the "Anglo-Saxon model").

- Governance standards are recommended in "U.K. Corporate Governance Code":
  - ✓ Separation of chairman and CEO roles.
  - ✓ Senior independent director.
  - ✓ Independent board and committees.
  - ✓ Board, directors, and committees subject to an annual review.
  - ✓ Emphasis on transparency of procedures and decisions.
  - ✓ Maintain sound internal controls.

(3) Japan

- History of strong interconnections among firms (“keiretsu”):
  - ✓ Cross-ownership among customers, suppliers, affiliates, and financiers.
  - ✓ Systems encourage business relations and cooperation toward shared objectives.

- Stakeholder-centric:
  - ✓ Maintain healthy employment.
  - ✓ Preserve wages and benefits.
  - ✓ Discourage hostile interactions among firms.

- Large boards comprised mostly of executive directors.

(4) China

- Partial transition from communism to capitalism:
  - ✓ Government continues to be the primary owner.
  - ✓ Protects societal concerns

    (maintain employment, protect key industries from foreign competition).

- Two-tiered board:
  - ✓ Board of directors: mostly company executives.
  - ✓ Board of supervisors: 33% employee representation.

- Individual shareholders are minority owners with little voting power.

- Little foreign ownership.

(5) India

- "Clause 49:" improved governance standards for listed companies (adopted 1999, revised 2004):
  - ✓ Majority of non-executives on the board.
  - ✓ If chairman is a non-executive (executive), 33% (50%) of board must be independent.
  - ✓ Board must meet at least four times a year.
  - ✓ A director cannot be a member of more than 10 committees across all companies.
  - ✓ Independent, financially literate audit committee.
  - ✓ Extensive disclosure of related party transactions

- Challenges to reform:
  - ✓ Underdeveloped capital markets.
  - ✓ Continued dominance of family-controlled business groups.

CORPORATE SOCIAL RESPONSIBILITY

- **Introduction**

Corporate social responsibility is a self-regulating business model that helps a company be socially accountable—to itself, its stakeholders, and the public.

To engage in CSR means that, in the ordinary course of business, a company is operating in ways that enhance society and the environment, instead of contributing negatively to them.

The concept of CSR aims to examine the role of business in society and to maximize the positive outcomes of business activity.

- **CSR in global context**

Recognizing this need, we extend the CSR concept to the country level and introduce the concept of global country social responsibility (GCSR), defined as a country's practices that contribute to the well-being of its key constituents or stakeholders, including immigrants, emigrants, native citizens, non-native citizens, as well as domestic and foreign businesses.

Justification of CSR

- **Defensive CSR:**

Minimising the potential bad effects of CSR on local communities, environments and markets when imposed through international supply chains and investments.

- **Proactive CSR:**

It involves business strategies and practices adopted voluntarily by firms that go beyond regulatory requirements in order to manage their social responsibilities, and thereby contribute broadly and positively to society.

CSR in international business

- Sustainable development and environment
- Human and labour rights
  - ✓ Be compliant
  - ✓ Be consistent
- Local economy and society
- Transparency

(1) Sustainable development and environment

Today's generation must invest for the future and stop borrowing from the future generation by wasting the resources at present.

And so there's a need to promote new economic development model, based on the context corporations should go beyond the minimum, this will bring turn to better consumer favor, product and process innovations, and raw material savings.

(2) Human and Labour rights

❖ **CSR Demands:**

➢ **Be Compliant:**

Operational conduct of the enterprise should not be lower than the standards.

➢ **Be Consistent:**

Have partners of the same kind in adopting the same observance and recognition of rights.

(3) Local economy and society

Large international enterprises bring extraordinary impact on the development of less-developed countries. However, problems occur in the differences on technological capability of the host country's lack of capacity to adapt.

Involvement of stakeholders is necessary in terms of relevant decisions that would contribute to the development of the territory or to the host country in particular and that it reduces investment risks.

(4) Transparency

Corporate transparency - is a form of deep-rooted managerial initiative which evolved into a philosophy of removing walls and facilitating free and easy public access to corporate information. It involves openness, communication and accountability.

Transparent measures include financial disclosure of statements, the freedom of information legislation, budgetary review and audits.

Thank
YOU