International Business Environment

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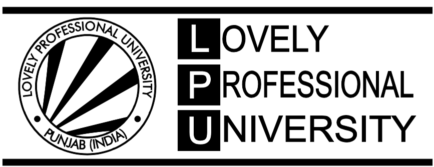
Edited by
Krishan Gopal



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UNIT 1: An Overview of International Business Environment

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1.1 Globalization

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Learning Outcomes

After studying this unit, you should be able

- relate with the international business environment
- relate with globalization
- identify different types of international business firms
- explain the influence of the environment on different types of international business firms

Introduction

One of the most important things that have driven international business for the past few decades is change. It can even be understood by one of the famous quotes by Prof. Leon C. Megginson. He said that "It is not the strongest or the most intelligent who will survive, but those who can best manage change."

Change plays a very important role when it comes to the environment. It gets even bigger in the role when associated with the international business environment. The same can be understood with the help of an example from the Swiss watch industry.

Example: Swiss companies' mechanical movements had proven their durability and reliability for centuries and made this industry market leader in 1970. But their reluctance to adopt quartz technology cost them dearly. Exports of Swiss mechanical watches plummeted from 40 million in 1973 to only 3 million, ten years later. Japan and Hong Kong dominated the quartz segment and decimated the Swiss industry. Many small- to medium-sized watch companies in Switzerland closed their doors by the end of the 1980s. This reflects that if an organization not keeping a note of changes in the environment in which it's operating, can lead to the downfall of the organization.

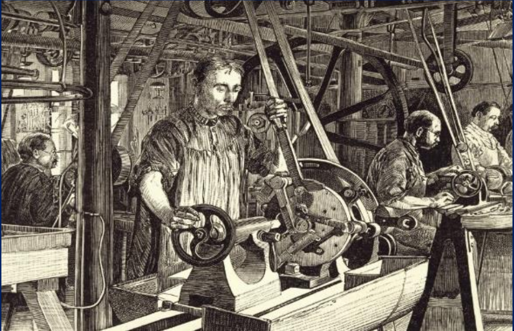
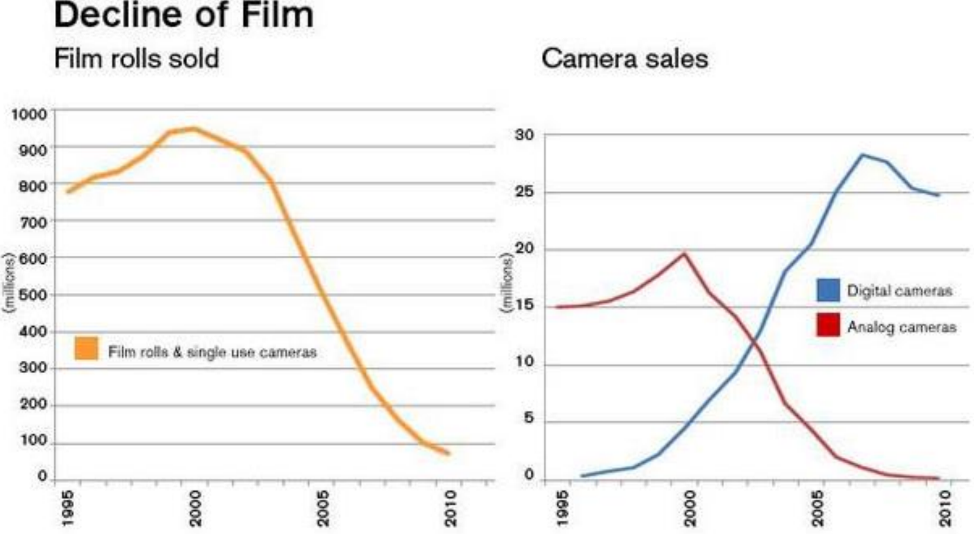


Fig. 1 Example: The Swiss Watch Industry

Another example that can be discussed on the technological change in the environment that lead to the downfall of the organization is Kodak.

Example: A generation ago, a "Kodak moment" meant something worth saving and savoring. Still, a few years ago Kodak experienced such a downfall in sales that it was forced into bankruptcy. After being founded by George Eastman in 1888, it became so dominant in photography that by 1976, 85% of all film cameras and 90% of all film sold in the US was Kodak. For almost a hundred years, Kodak was at the forefront of photography with dozens of innovations and inventions, making this art accessible to the consumer. In the 1980s, the photography industry was beginning to shift towards the digital. With Kodak inventing the digital camera, one would think that turning to digital would be the next logical thing for Kodak. The company jumped on the digital trend bandwagon although it was a late adopter while still selling analog cameras and film.



As it turned out, digital cameras were not the biggest fish in the pond. Smartphones took the world by storm and digital camera producers saw their sales quickly spiraling down. People went from printing pictures to storing them on digital devices or sharing them online on social media platforms. Kodak created a digital camera, invested in the technology, and even understood that photos would be shared online. Where they failed was in realizing that online photo sharing was the new business, not just a way to expand the printing business. Therefore, it is necessary to understand the international business environment and globalization in a true sense to have an edge over competitors.

1.1 Globalization

It refers to the elimination of barriers to international movements of goods, services, capital, technology, and the people that influence the integration of world economies.

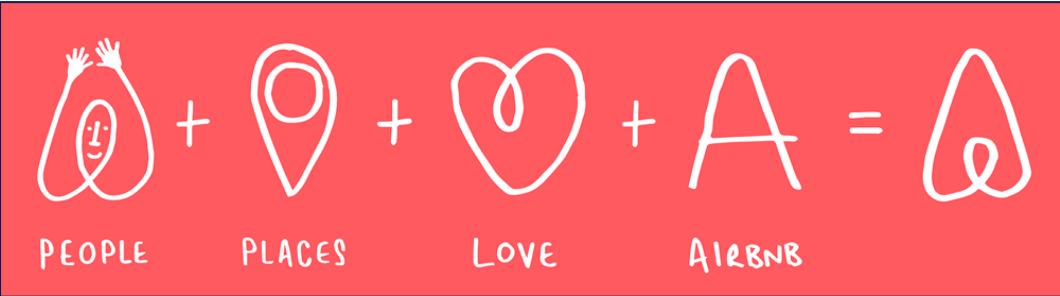
"Going global" is termed as a gradual process, starting with increased exports or global sourcing, followed by a modest international presence, growing into a multinational organization, and ultimately evolving into a global posture.

Example: Airbnb started in 2008 and now has its footprints in more than 200+ countries.

It is an online community marketplace that connects people looking to rent their homes with people who are looking for accommodation. The key to Airbnb's global strategy is localization. This example reflects the impact of globalization, in such a short period this organization has expanded its operation in 200+ countries. The brand has introduced a universal symbol as its logo – the Belo – which symbolizes 'belonging' no matter where you are in the world.

The basic problem that Airbnb has to solve is bridging the global-local gap. On one side, one has to consider certain parts of the travel experience that must be applied in all places, like cleanliness standards. All wants freshly laundered bedsheets. On the other side, what makes Airbnb stand out from the millions of hotel rooms you can stay in is the uniqueness of the local experience. For

example, translation becomes a delicate aspect. If you're traveling to China from the U.K., you probably want to read home listings in English. But if Airbnb automatically translated Chinese profiles, visitors might expect that their host speaks English as well. The current solution: displaying profiles in the local language, and adding an optional translate button.



Factors in increased globalization:

- The rise in the application of technology
- Liberalization of cross-border trade and resource movements
- Development of services that support international business
- Growth of consumer pressures
- Increase in global competition
- Changes in political situations and government policies
- Expansion of cross-national cooperation

To protect its industries, every country restricts the entry and exit of not only goods and services but also the resources like workers, capital, tools, etc. However, most governments have reduced such restrictions, primarily for three reasons:

- Their citizens want a greater variety of goods and services at lower prices.
- Competition spurs domestic producers to become more efficient.
- They hope to induce other countries to lower their barriers in turn.

Increased competitive pressures can persuade companies to buy or sell abroad.

Example: A firm might introduce the product into the markets where competitors are already gaining sales, or seek supplies where competitors are getting cheaper or more attractive products.

Governments support programs such as improving airport and seaport facilities to foster efficiencies for delivering goods internationally. Governments also provide an array of services to help local firms sell more in foreign markets. Regulating authorities like government and international bodies have to realize that their interest can be addressed through international cooperation employing treaties and agreements.

This has happened largely due to:

- To gain reciprocal advantages
- To attack problems jointly that one country acting alone cannot solve
- To deal with areas of concern that lie outside the territory of any nation.

1.2 International Business

It encompasses all commercial activities that take place to promote the transfer of goods, services, resources, people, ideas, and technologies across national boundaries. However, a broader definition of international business may serve you better both personally and professionally in a world that has moved beyond simple industrial production. exchanges can go beyond the exchange of money for physical goods to include international transfers of other resources, such as people, intellectual property (e.g., patents, copyrights, brand trademarks, and data), and contractual assets or liabilities (e.g., the right to use some foreign asset, provide some future service to foreign customers, or execute a complex financial instrument). The entities involved in international business range from large

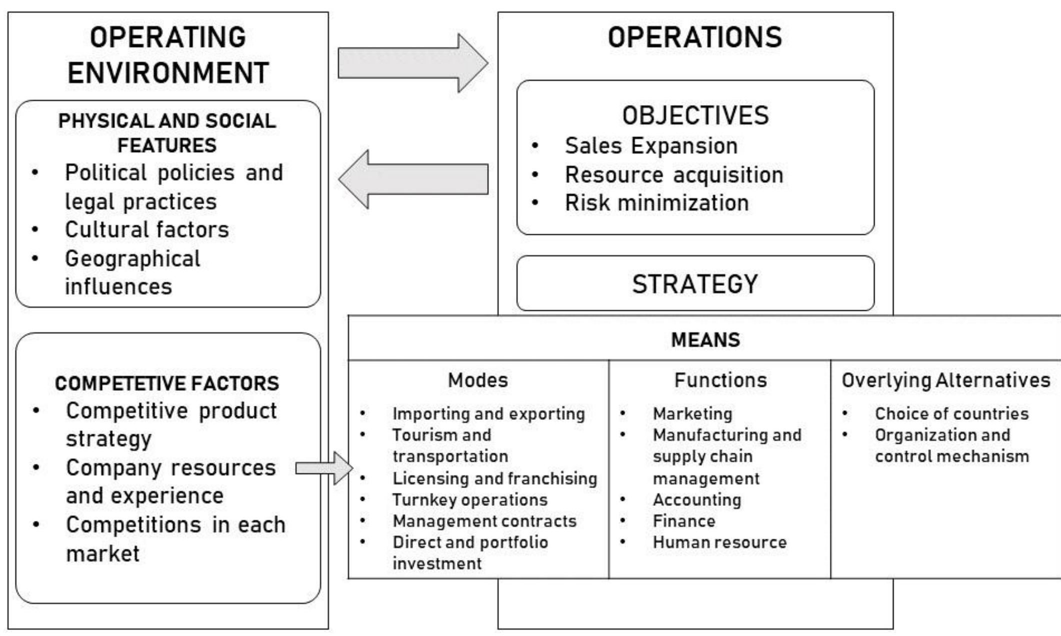
multinational firms with thousands of employees doing business in many countries around the world to a small one-person company acting as an importer or exporter. This broader definition of international business also encompasses for-profit border-crossing transactions as well as transactions motivated by nonfinancial gains (e.g., triple bottom line, corporate social responsibility, and political favor) that affect a business's future.

International business includes any type of business activity that crosses national borders. Though several definitions in the business literature can be found no simple or universally accepted definition exists for the term international business. At one end of the definitional spectrum, international business is defined as an organization that buys and/or sells goods and services across two or more national boundaries, even if management is located in a single country. At the other end of the spectrum, international business is equated only with those big enterprises, which have operating units outside their own country. In the middle are institutional arrangements that provide for some managerial direction of economic activity taking place abroad but stop short of controlling ownership of the business carrying on the activity.

Influence of International Business

Because most of the countries are not as fortunate as India in terms of market size, resources, and opportunities, they must trade with others to survive; Hong Kong has historically underscored this point well, for, without food and water from china proper, the British colony would not have survived along. The countries of Europe have had a similar experience since most European nations are relatively small in size. Without foreign markets, European firms would not have sufficient economies of scale to allow them to be competitive with US firms. Nestle mentions in one of its advertisements that its own country, Switzerland, lacks natural resources, forcing it to depend on trade and adopt the geocentric perspective. International competition may not be a matter of choice when survival is at stake. However, only firms with previously substantial market share and international experience could expand successfully.

Factors in International Business Operations



It starts with the objectives of the organization as mentioned in the figure above. An organization can make a move for going international because an organization is interested in sales expansion, resource acquisition, or risk minimization. Once the domestic market is getting saturated for the organization, objectives like sales expansion will come in handy for such an organization. Similarly, if an organization believes that resources are available at a cheaper cost in some other country then this could also serve as an objective for moving into the international market. Diversification leads to risk minimization and this could be yet another objective for organizations in moving towards international markets.

When an organization moves to the international market, the operating environment plays a crucial role as these factors are beyond the control of the organization. An organization has to pay attention to all factors that are a part of the operating environment as these factors influenced organization operations significantly. You will be reading about the same in the next unit. Organizations will keep changing their strategies depending upon which factor is creating an impact on the operations of the organization.

An organization is going to adopt various measures to enter in international arena like discussing the mode of entry. An organization can opt for any of the options mentioned in the figure like licensing, franchising, turnkey operations, importing, and exporting. It depends on which mode is best going to suit the organization taking into consideration the product or service in which the organization deals.

Example: Let us take an example of a cricket series taking place in England. Indian team fans want to watch their team performing live. Their tickets on British air and travel expenses in England are service exports for Britain and service imports for India.

On an international level, for example, companies receive fees for engineering services rendered in turnkey operations. Companies also receive fees from management contracts arrangements in which they provide personnel to perform management functions for another such as Disney's management of theme parks in France and Japan.

Competitive factors also play a vital role in overall international business operations. Competitive factors (such as the number and strength of suppliers, customers, and rival firms) are all important for an organization. The influence of all these factors will be seen in units ahead.

1.3 Types of International Business Firms

International Company:

International companies are importers and exporters, they have no investment outside of their home country. The functioning and strategies are derived mostly from the primary market which is the domestic home country market. They have to continuously adjust to the trading norms of the home country.

Example: Spencer's Retail is an Indian chain of retail stores headquartered in Kolkata, West Bengal which is providing a wide range of products across categories such as food, personal care, fashion, home essentials, specialty, and electrical and electronics to its consumers.

Multinational Company:

Multinational companies have an investment in other countries but do not have coordinated product offerings in each country. More focused on adapting their products and service to each local market. MNC's have a centralized structure, with the head office in the home country taking important decisions. Products are decided and developed by the head office and subsidiary offices do have options to adapt to local markets if needed.

Example: Adidas AG is a German multinational corporation that designs and manufactures shoes, clothing, and accessories. It is the largest sportswear manufacturer in Europe and the second-largest in the world after Nike.

Global company:

Global companies have invested and are present in many countries. They market their products through the use of the same coordinated brand in all markets. The corporate office is responsible for global strategy. Emphasis on volume, cost management, and efficiency remain the key factors. These companies work to have a foothold in a large number of countries, usually larger than a Multinational Corporation. Various subsidiaries are set but standard products are sold, without any flexibility in terms of adapting to local consumers. There is no change in branding or information about a global company, even if the country of operations changes.

Example: Ikea was founded in 1943 and has been the world's largest furniture retailer since 2008, with over 420 distinctive stores in more than 50 countries. It has a successful business model focused on offering stylish flat-pack furniture at affordable prices.

Transnational Company:

Transnational companies are much more complex organizations. They have invested in foreign operations, have a central corporate facility but give decision-making, R&D, and marketing powers to each foreign market. Transnational companies follow a flexible approach, understanding and adapting to the local culture and demand of each country. Offices in each country work in a decentralized manner with decision-making powers. Subsidiary offices can launch and make products that might not be manufactured in the original home country if there is a chance of demand.

Example: Unilever operates in more than 100 countries, selling its products in more than 190 countries. The Company operates approximately 310 factories in over 70 countries. It operates a network of over 400 warehouses globally. The Company's brands include Axe, Dove, Lux, Rexona, and Sunsilk. Unilever has become a transnational company in the most basic sense: it thinks globally as well as acts locally.

Similarly, we have other examples like McDonald's, Coca Cola and Vodafone.

Characteristics of a Transnational company

This company thinks globally and acts locally. This company adopts a global strategy but allows value addition to the customer of a domestic country. The assets of a transnational company are distributed throughout the world, independent and specialized. The R&D facilities of a transnational company are spread in many countries.

Scanning or Information Acquisition: These companies scan the environmental information regarding the economic, political, social and cultural, and technological environment. These companies collect and scan the information regardless of geographical and national boundaries.

Vision and Aspiration are global, global markets, global customers, and grow ahead of other global/transnational companies.

Geographical Scope*:* They analyze the global opportunities regarding the availability of resources, customers, markets, technology, research, and development, etc. The scope is not limited to certain countries in analyzing opportunities, threats, and formulating strategies.

Adaptation: Global and Transnational companies Adapt their products, marketing strategies, and other functional strategies to the environmental factor of the market concerned.

Mercedes Benz is a super luxury car in North America, luxury in Germany, and standard taxi in Europe.

Global Company is the one which has either produce in the home country or a single country and focuses on marketing these products globally and focuses on marketing these products domestically.

Self-Assessment

Multiple Choice Questions

1. The widening set of interdependent relationships among people from different parts of the world is known as ________.

a) Globalization
b) Offshoring
c) Franchising

d) Outsourcing

2. Which of the following best defines international business?

a) It includes all economic flows between two or more countries.
b) It includes all private economic flows between two or more countries.
c) It includes all business transactions involving two or more countries.
d) It includes all business transactions in countries other than your home country.

3. In terms of international business, it is most accurate to say that ________.

a) there is a universal "best way" to conduct business
b) global competition affects large companies but not small ones
c) most firms depend either on foreign markets and supplies or compete against companies that do
d) government regulation of international business has little effect on a company's profits

4. Devon, an accounts manager at a large electronics firm, does not have any direct international responsibilities; however, Devon would most likely benefit from studying international business issues so that he can ________.

a) conduct better job interviews
b) better understand how foreign operations affect the company's competitive position
c) supervise and evaluate subordinates who have global assignments
d) understand the legalities of importing and exporting products overseas

5. The shifting of national borders has most likely created which of the following situations for international business?

a) It has left rural residents more isolated from technology.
b) It has complicated the understanding of behavioral factors affecting business.
c) It has increased physical barriers to exporting.
d) It has slowed communications between a company's headquarters and foreign operations.

6. The shifting of national borders has most likely created which of the following situations for international business?

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b) It has complicated the understanding of behavioral factors affecting business.
c) It has increased physical barriers to exporting.
d) It has slowed communications between a company's headquarters and foreign operations.

7. Most of the world's goods and services are sold ________.

a) in international markets
b) in the countries where they are produced
c) through exports to small countries
d) through exports to large countries

8. Which of the following has NOT been a major force increasing globalization in recent decades?

a) liberalization of cross-border trade
b) increase in and expansion of technology
c) growing pressure from consumers
d) decreasing prices of natural resources

9. Which of the following best explains why the international business has grown rapidly in the past few decades?

a) the end of the political division between the Communist and non-Communist blocs
b) greater income equality in most countries
c) growing concern about climate change
d) increased concerns about terrorism

10. Imported flowers are now a stronger competitor to U.S. grown flowers in the U.S. market. Which of the following is likely the MOST important factor for this increase in imports?

a) more effective production techniques
b) advances in communication systems
c) advances in transportation and logistics

d) cross-national cooperation

11. Because consumers want a greater variety of goods and services at lower prices, many governments have ________.

a) reduced their restrictions on the international movement of goods and services

b) acted to tax most imports at a lower rate than domestic products

c) sought to eliminate reciprocal advantages negotiated through international organizations and treaties

d) increased their participation in multinational problem-solving efforts

True/False

12. Gaining some understanding of international business is important for any business student because global events and competition affect almost all companies.

13. It is difficult to compare the globalization of business over time because shifting national borders have changed the nature of transactions from domestic to international and vice versa.

14. Globalization refers to all economic transactions among countries.

15. International business includes all commercial transactions between two or more countries.

Summary

This unit attempts to give an overview of the international business environment and globalization in an as simple manner as possible.

International business is all commercial transactions whether private and governmental between two or more countries. Private companies undertake such transactions for profits; Government may or may not do the same. These transactions include sales, investments, and transportation.

Study of international business has become important because (i) it comprises a large and growing portion of the world's total business, (ii) All companies are affected by global events and competition whether large or small since most sell output to and secures raw materials and supplies from foreign countries. Many companies also compete against products and services that come from outside their home country.

The company's external environment conditions such as the physical, societal, and competitive affect the business functions such as marketing, manufacturing, and supply chain management are carried out.

Globalization refers to the elimination of barriers to international movements of goods, services, capital, technology, and the people that influence the integration of world economies.

When a company operates internationally, foreign conditions are added to domestic ones ⌘⌘making the external environment more diverse and complex.

In international operations, organizations can be categories into different types like international, multinational, global, and transnational. It depends upon the nature of the product or service in which the organizations might be dealing.

Keywords

International Business: relates to any situation where the production or distribution of goods or services crosses country borders.

Globalization: means the speedup of movements and exchanges (of human beings, goods, and services, capital, technologies, or cultural practices) all over the planet.

International Company: International companies are importers and exporters; they have no investment outside of their home country.

Multinational Company: Multinational companies have an investment in other countries, but do not have coordinated product offerings in each country.

Global Company: Global companies have invested and are present in many countries. They market their products through the use of the same coordinated brand in all markets.

Transnational Company: Transnational companies are much more complex organizations. They have invested in foreign operations, have a central corporate facility but give decision-making, R&D, and marketing powers to each foreign market.

Review Questions

1. What is international business? What are the primary reasons that companies engage in international business?

2. What is globalization? What modes of international business are used by firms that want to globalize?

3. Why should domestic managers have an understanding of globalization and international business?

4. What are the factors that have led to the increased in globalization in recent decades?

5. In a short essay, discuss why governments have been liberalizing cross-border movements of goods, services, and resources.

Answers of Self-Assessment

1	A	2	C	3	C
4	B	5	C	6	C
7	B	8	D	9	A
10	C	11	A	12	True
13	True	14	False	15	True

Further Readings

International Business: Environments and Operations, 16th Edition by Daniels, Radebaugh and Sullivan et all. Pearson

Charles W.L. Hill, International Business Competing in the Global Marketplace,4th Edition, Tata McGraw Hill, Publishing Company Limited.

International Business Environment and Management, by V. K. Bhalla and S. Shiva Ramu Anmol Publication and PVT. Ltd.

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Unit 02: Components of International Business Environment

CONTENTS

Objectives

Introduction

2.1 Cultural factors

2.2 Political and Legal Factors

2.3 Economic Factors

Shadow Economy

2.4 Technological Factors

Summary

Keywords

Self-Assessment

Answer for Self Assessment

Review Questions

Further Reading

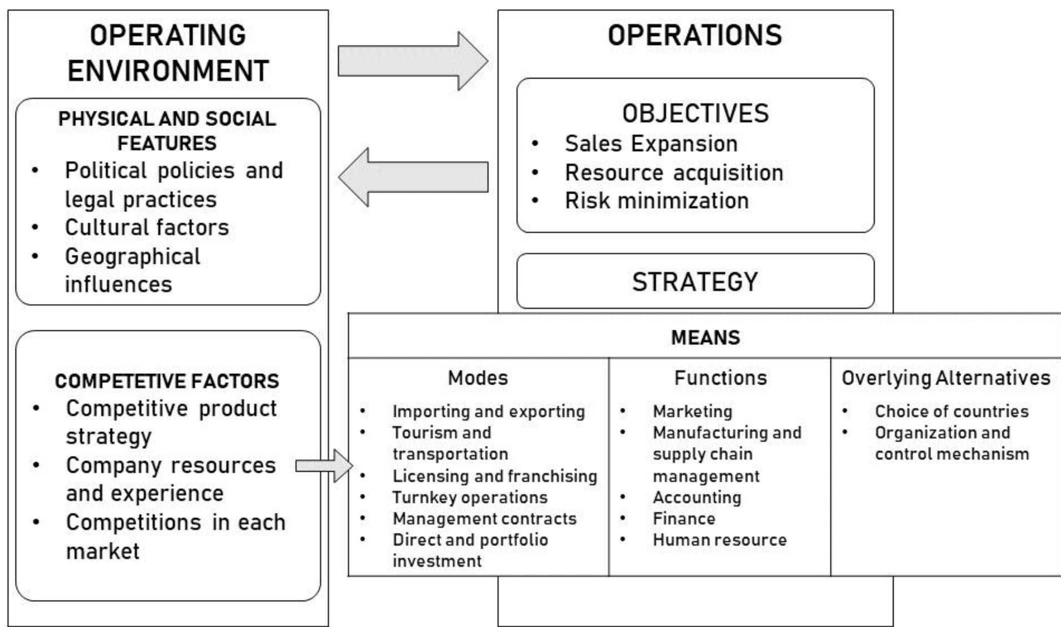
Objectives

After studying this unit, you should be able to

- discuss the changing social structure and correlate the same with globalization
- analyze the changing political and legal environment and correlate the same with international business
- illustrate the changing economic environment and correlate the same with international business
- discuss the changing technological environment and correlate the same with international business

Introduction

Multinational companies operate in different geographic regions around the world and have to deal with a wide variety of economic, political, legal, socio-cultural, and technological factors. These factors constitute an operating environment that includes political, social, legislative, economic, cultural, and natural environmental factors that significantly affect the business of any international firm. These factors need to be considered during planning to ensure the strategies fit the operational environment and are based on current local conditions.



When an organization moves to the international market, the operating environment plays a crucial role as these factors are beyond the control of the organization. An organization has to pay attention to all factors that are a part of the operating environment as these factors influenced organization operations significantly. As the operating environment inserts its impacts on business success, scale, vision, and development strategy, having a full understanding of this issue should be prioritized by top management of the companies. Let us try and understand the impact of each of these factors one by one.

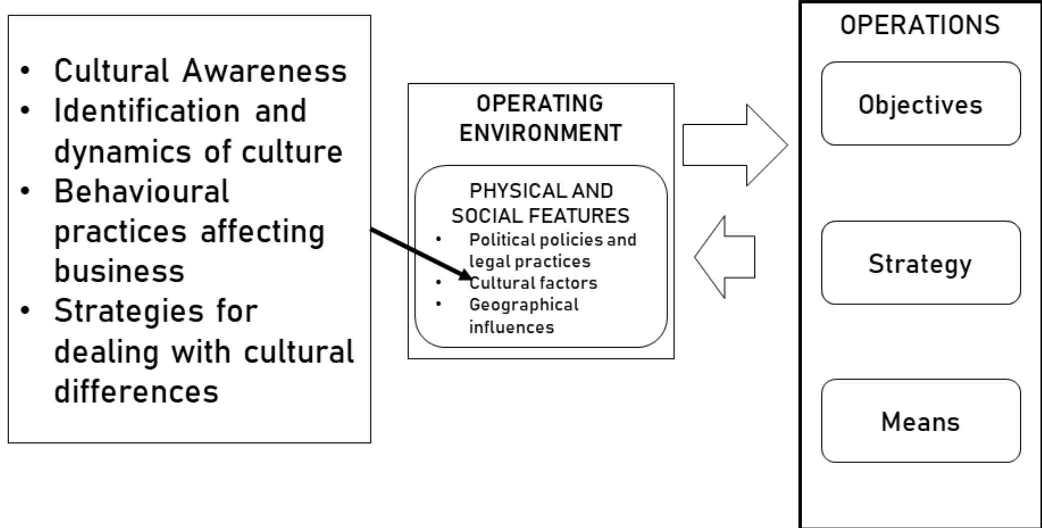
2.1 Cultural factors

Culture and society have an impact on each aspect of the international business of multinational companies. However, culture and society are not directly included in international business operations; they indirectly appear as important elements in directing how the business is managed, from what products are manufactured, and how and through what ways they will be sold, to the creation of managerial and operational patterns and the evaluation of the success or failure of foreign subsidiaries. International companies should be aware of predominant attitudes, values, and beliefs in each host country were decided to expand their business activities. The degree of differences in attitudes and values among management of a parent company and expatriate managers at the subsidiary level, on the one hand, and managers and employees in host countries, on the other, can contribute to serious functional problems. Getting clarity of the cultures of different people is useful because business employs, sells to, buys from, is regulated by, and is owned by people. The socio-cultural environment is important for multinational companies. Various socio-cultural factors significantly affect the economic activity as well as the performance of multinational companies. The key socio-cultural factors that have a major impact on the operation of multinational companies:

The shared values, attitudes, and beliefs of a group of individuals constitute a culture. Values form the bedrock of culture. They provide the context within which a society's norms are established and

justified. Values are learned, and all individuals have them. They are reflected in their attitudes, beliefs, and actions. Their core values are so strong that they are not negotiable, whereas peripheral values are less dominant. The nation provides a workable definition of culture because similarity among people is both a cause and effect of national boundaries. It is a reference people make to we versus them. Despite using the nation as a cultural reference point not everyone therein shares the same values and attitudes. Subculture exists within nations.

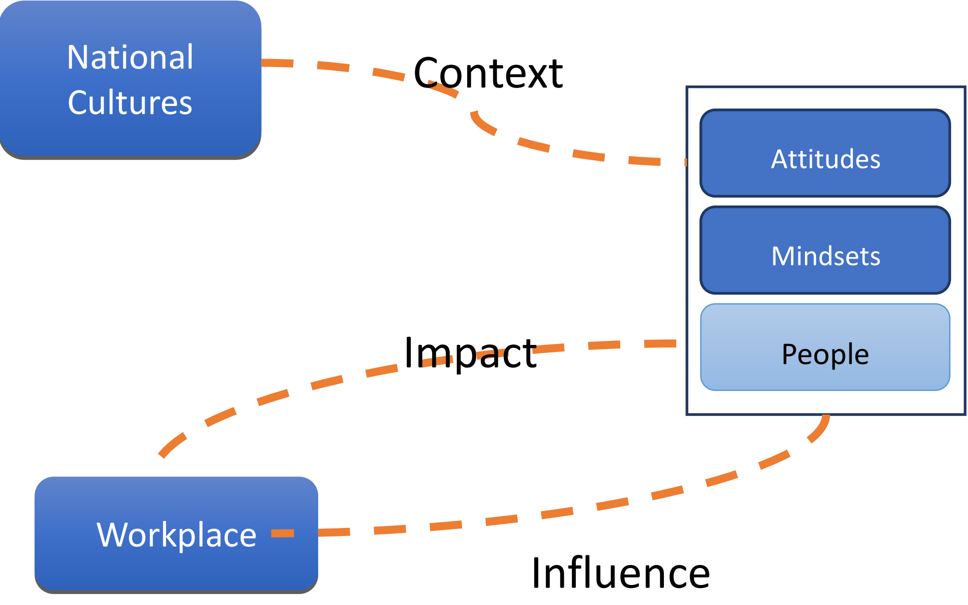
Social-cultural factors affecting International Business Operations



The main points that are highlighted in the above figure related to cultural factors are cultural awareness, identification and dynamics of cultural behavior, behavioral practices affecting business, and strategies for dealing with cultural differences. When we talk about cultural awareness, it's an important aspect for multinational companies as they are supposed to understand the culture of the host country for better serving the target market. Multinational companies are supposed to formulate strategies so that they can deal appropriately with cultural differences that home and host countries are having.

Hofstede's Comparison of National Culture

Hofstede's Cultural Dimensions Theory, developed by Geert Hofstede, is a framework used to understand the differences in culture across countries and to discern the ways that business is done across different cultures. In other words, the framework is used to distinguish between different national cultures, the dimensions of culture, and assess their impact on a business setting.



Five dimensions of Culture

- Power distance
- Uncertainty and avoidance
- Individualism vs. Collectivism
- Masculinity vs. Femininity
- Long-term and short-term orientation

Power distance:

It is a measurement of employee preferences of interaction between superiors and subordinates. Evidence suggests that people perform better with these interactions that fit their preferences. With high power-distance, people prefer little consultation between bosses and subordinates.

Uncertainty and Avoidance:

It describes a trait of being uncomfortable with ambiguity. Where this trait is strong, most employees prefer to follow set rules even if breaking them may be in the company's best interests.

Individualism vs. Collectivism:

High individualism describes a preference to fulfill leisure time, build friendship, and improve skills independently of the organization. Such employees also prefer to engage in personal decision-making and on-the-job challenges. This reflects societies where ties between individuals are loose.

High collectivism reflects employee's penchant for dependence on the organization through training, satisfactory workplace conditions, and good benefits. Societies where people are integrated often from birth, into strong, cohesive groups, embracing loyalty and bonds reflect high collectivism.

Masculinity vs Femininity:

Masculinity applies when gender roles are assigned, implicitly or explicitly, to males, reflecting being tough, assertive, seeking material rewards, and to females reflecting tenderness and quality of life.

Femininity applies when tenderness and quality of life are assigned, implicitly or explicitly, to both males and females.

Long-term and short-term orientation:

Long-term orientation culture reflects a fostering virtue towards future rewards in particular perseverance and thrift.

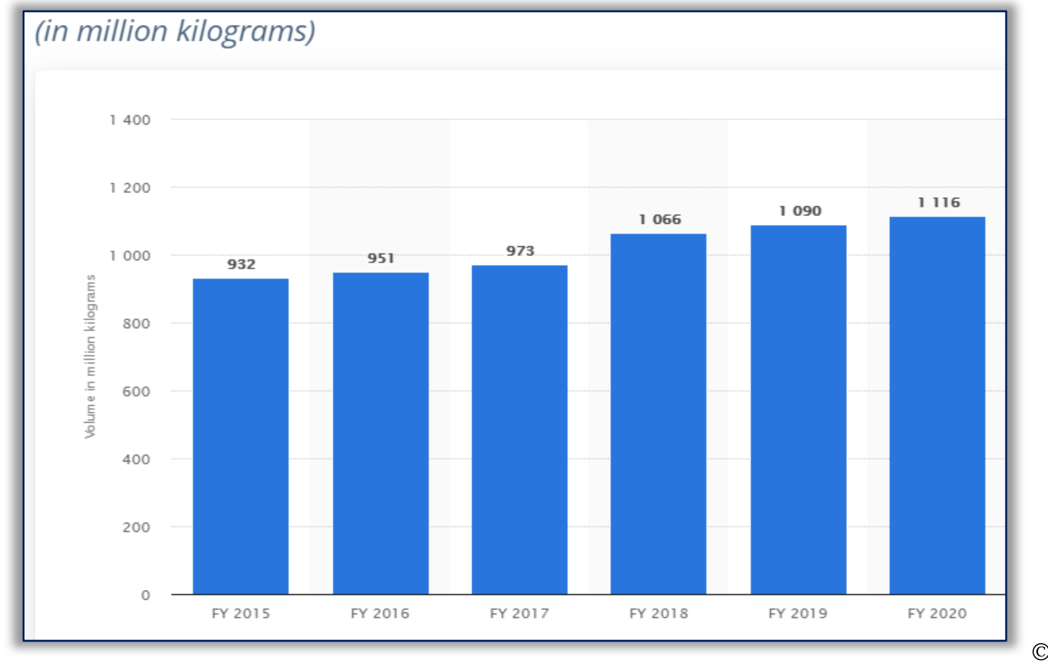
Short-term orientation culture reflects a fostering of virtues related to the past and present in particular respect for tradition, preservation of face, and fulfilling social obligations.

International Business involves people from different national cultures, which affect every business function- managing a workforce, marketing and transporting output, purchasing supplies, dealing with regulators, securing funds. Cultural diversity can be a competitive advantage, but managing it can be difficult. Let us understand the same with the help of an example.

Case of Starbucks: Starbucks started way back in 1971 in the United States and established its presence now in 76 countries. It is having more than 30000 stores across the globe and generated revenue of $4 billion in 2019.

Starbucks started its efforts to enter the Indian market from 2006 onwards and made several attempts to ally with some local companies but it did not work out. Finally, in 2012 Starbucks did a 50/50 joint venture with Tata Global beverage limited and opened its first store in Oct. 2012. This move of Starbucks was taken by surprise as industry experts were thinking that the company may enter India without a partner. It was there in the mind of analysts because the Government of India allowed 100% FDI in single-brand retail in 2012 itself. The locations were branded as "Starbucks Coffee — A Tata Alliance," an unusual move, as the Seattle firm does not typically sell its products under a hybrid brand. But in India, they did it to make a better connection with the target market as Tata is considered a very reliable brand in the Indian market. Starbucks decision to enter the Indian market was also supported by the change in preference of beverage in a certain section of the

society. Let us understand the same with the help of some statistics on the consumption volume of tea and coffee in India from the financial year 2015-2020.



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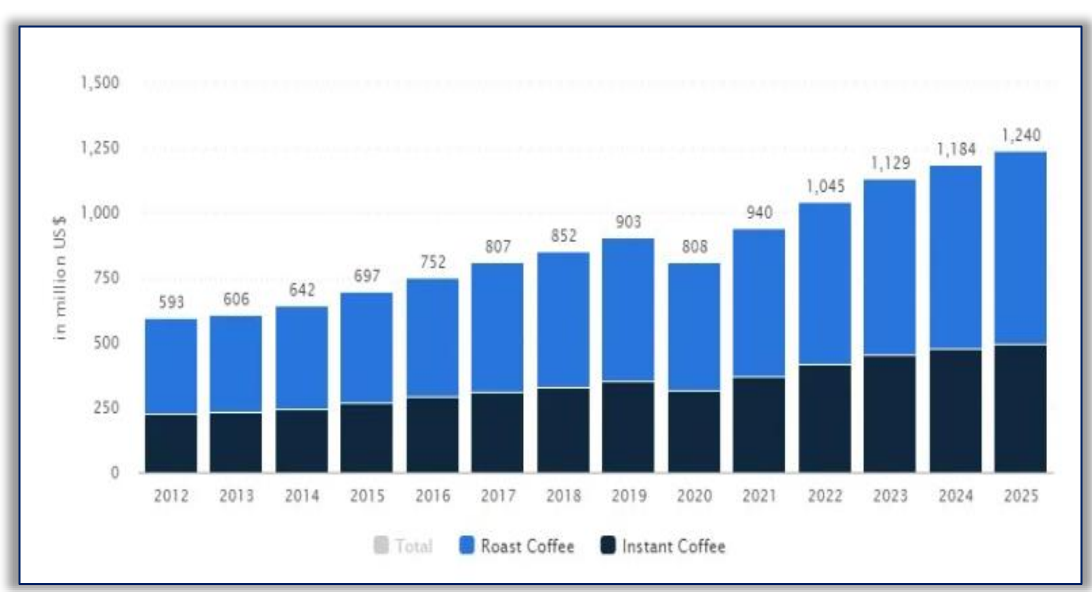
The consumption volume of tea in India was approximately one billion kilograms during the financial year 2020. Consumption of this hot beverage has increased consistently throughout the years. Year on year growth rate remains approximately 2% for tea in the country. India's per capita tea consumption is 0.78 kg per year till 2020.

However, tea remains the preferred drink among Indians but coffee is on the rise in this new millennium. In the past decade alone, domestic consumption of coffee has grown at more than double the rate of tea. If we analyze the consumption volume of coffee in India, it can be seen from the chart below that consumption of coffee is on the rise.



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According to the reports of Statista, the coffee segment amounts to $808m and is expected to grow annually by 8.9% CAGR in 2020-2025. In India, the average per capita consumption and revenue stood at 0.03 kg and $0.6 in 2020. India has always been a 'chai' nation. And, coffee or rather 'kaapi' as it is called down South, has been a humble beverage that's now an integral part of the 'let's hang out' culture. According to a Euromonitor study, coffee consumption in India is closely associated

with out-of-home consumption, mainly by young consumers with high disposable incomes. Also, the growth of cafe chains over the last decade has boosted the visibility and per capita consumption of coffee in India.

Starbucks in India tried to build up what they call the 'third place' experience, where they wanted their consumers to come for the coffee, stay for the warmth, and return for the human connection. Starbucks stores across the world have this whole feeling of having values from the neighborhood and fit into the culture beautifully. For instance, their flagship store in Hyderabad is designed with the elements of Hyderabadi pearls. The same can be seen in the picture below.

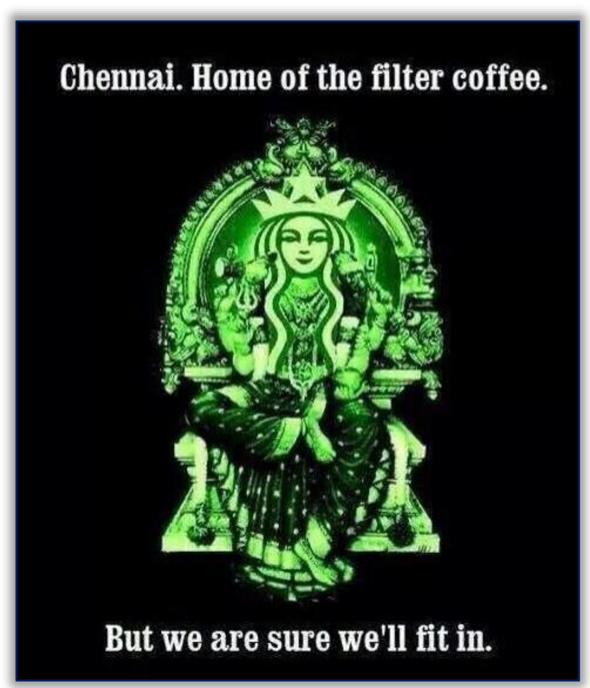
The flagship store in Pune has copper elements because the city has a history with copper.

It can be noted that no two Starbucks stores look similar, and the flagship ones are where a lot of local inspiration can be seen. Starbucks ' efforts to fit in with the Indian culture continued as the company brought eatables along with coffee in its menu. Indians have the habit of eating along with coffee/tea. So, Starbucks has introduced Indian dishes like Konkani Twist or a Reshmi Kebab Roll in their menu along with other tried and tested muffins and sandwiches. Indians prefer tea more than coffee. Hence, Starbucks has introduced Tata's branded tea called Teavana and Himalayan water beverages to add to the products.

The success and acceptance of Starbucks by different cultures stems from its carefully planned business strategy – localization. With localization, Starbucks can adapt to the tastes of different cultures, managing to convince consumers in other locations to drink coffee. This is particularly impressive in Asia where tea is the preferred drink.

The service ensures that all information about a company and product is in the local language. In some cases, it requires some changes in the brand's colors and appearance as well as adapting the brand name to fit the local culture. Company websites are localized, making them available in the local language and conforming to local preferences, traditions, beliefs, laws, and regulations.

Starbucks kept its price competitive in India as compared to its competitors like CCD, Barista, etc as India is a price-sensitive market. Starbucks was able to bring down the cost of procurement of coffee due to its partner Tata. All the Starbucks coffee available in the Indian market is supplied by TATA Coffee. As a result, Starbucks saves a lot of money by not importing coffee.



Example: Starbucks Localization Strategy

This example reflects the importance of adapting to the culture of the host country for getting a better return on investment. Starbucks has done that fairly well in the Indian market as it has done in various other countries.

Company and Management Orientation

A company and its managers adapt abroad depends not only on the host, country culture but also on their attitudes. This includes:

- Polycentrism
- Ethnocentrism
- Geocentrism

Polycentrism:

The polycentric organization believes it should act abroad like companies there. However, polycentrism may be the overly cautious response to cultural variety, causing a firm to shy away from certain countries or avoid transferring home-practices or resources that will work well abroad.

Ethnocentrism:

Ethnocentrism reflects the conviction that one's practices are superior to those of other countries. In international business it usually applied to a company so strongly committed to the principles of what works at home will work abroad that its foreign practices ignore the difference in culture and markets. This leads to sometimes poor performance.

Geocentrism:

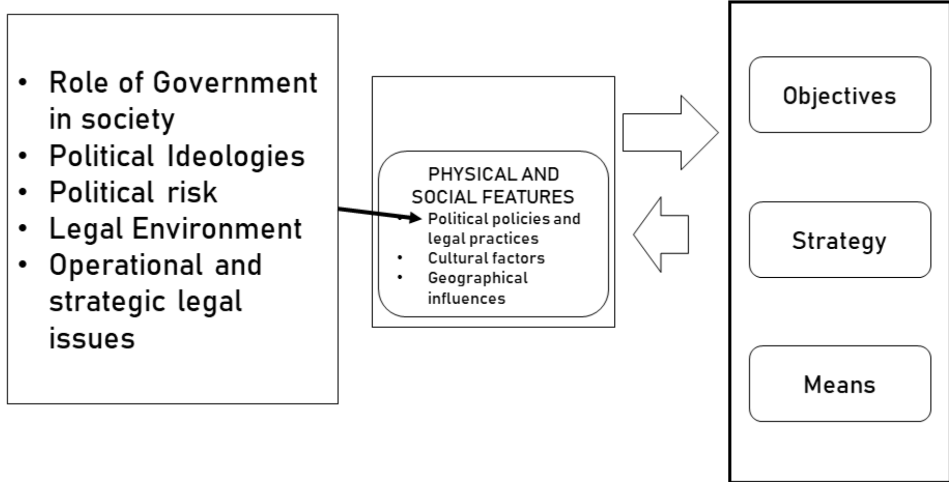
It integrates home-and host-country practices as well as introducing some entirely new ones. It requires companies to balance informed knowledge of their own organization culture with home- and host-country needs, capabilities, and constraints.

2.2 Political and Legal Factors

A very famous quote by Mr. Hunter S. Thompson "Politics is the art of controlling your environment." It reflects the impact of the political factor on overall international business operations. Politics and laws are always and everywhere dynamic. At different times, different parties champion different ideologies that endorse different political systems. Despite the globalization of business, firms must abide by the local rules and regulations of the countries in which they operate. Until recently, governments were able to directly enforce the rules and regulations based on their political and legal philosophies. The Internet has started to change this, as sellers and buyers have easier access to each other. Nevertheless, countries still can regulate or strong-arm companies into abiding by their rules and regulations. As a result, global businesses monitor and evaluate the political and legal climate in countries in which they currently operate or hope to operate in the future.

Normally, Multinational Firms are more comfortable investing in markets with a good political environment and law transparency, to assure game rules will not change dramatically making them pay more money for those changes or even lose their investments. Legal factors affecting business include all regulatory and law determinants that can negatively or positively affect results of market actions and decisions of the management of a company functioning in a particular country. International companies must analyze and identify those factors (legal environment) independently for every state they function. Consequently, investing and operating internationally exposes MNE to risks that arise from a change in a country's political system.

Political and legal factors influencing international business operations



As we can see from the exhibit above, factors such as the role of government in society, political ideologies, political risk, legal environment, and operational and strategic legal issues impact international business operations to a large extent. Multinational enterprises need to make changes in their modus operandi. Let us understand the same with one of these factors like political risk.

Source-Fitch Solutions

This political risk map provides a perspective for more than 200 countries and territories. Countries highlighted with red and yellow are more unstable concerning political, economic, and operations risks. Whereas countries highlighted with blue shades are the stable ones. This map is reflecting it on a scale from 0-100. The degree of political risk threatens the short-term profit and long-term sustainability of the business activity. Therefore, managers evaluate politics and law and estimating the resulting risks to the profitability and sustainability of their operations. Let us understand the same with help of an example.

The trade war between the United States and China reflects the political risk for the companies operating in these two countries. One of Trump's main 2016 campaign themes was that the United States, the world's biggest economy had been taken advantage of by its trade partners and he pledged to shake up global trade arrangements and eliminate the nation's trade deficit. That was indicating towards the change in a

political and legal environment.

The goal of the political system is to integrate the diverse elements of society. Its test is sustaining society in the face of divisive viewpoints. The legal system is the mechanism for conceiving, stipulating, interpreting, and enforcing the laws in a formal jurisdiction. After four years in office, President Donald Trump has failed to achieve his promise to eliminate the US trade deficit and dealt a lasting blow to the multilateral economic system that global trade is based upon.

Trump has indeed shaken up the global trading system but the US trade deficit has grown under his presidency. Trump's trade policies have delivered few tangible benefits to the US economy while undercutting the multilateral trading system, disrupting long-standing alliances with US trading partners, and fomenting uncertainty. While the US trade deficit with China which was Trump's main target has indeed shrunk, imports from Canada and Mexico have jumped, deepening the overall deficit. The import tariff increases that Washington has imposed on many products have protected American manufacturers. But those tariffs also "raised production costs" for the US industry and demonstrated the extent of the reliance on Chinese suppliers. The global economic infrastructure has gone into a deep state of flux.

Trump's refusal to appoint new judges had paralyzed the World Trade Organization's dispute resolution system, hobbling the arbitrator of the world's multilateral trading system. The truce in the US-China trade war reached in January 2020 left unsolved major points of contention such as intellectual property theft and forced technology transfers. Trump's four years in office have resulted in the weakening of the rules-based multilateral trading system, embodied by the WTO, that the US was instrumental in setting up. The positions of both Democrats and Republicans have hardened in recent years towards China, which is now viewed as a rival that needs to be contained as it has not evolved into a liberal market economy as had been hoped. The trade war was inevitable given China's economic rise and persistence with high levels of state intervention rather than adoption of market forces. This reflects how a political system can bring complexities for the companies operating in the international business arena. This also takes us towards the concept of individualism and collectivism.

Individualism

The doctrine of individualism emphasizes the primacy of individual freedom, self-expression, and personal independence. Individualism champions the exercise of one’s ambitions while opposing regulations that constrain them.

Collectivism

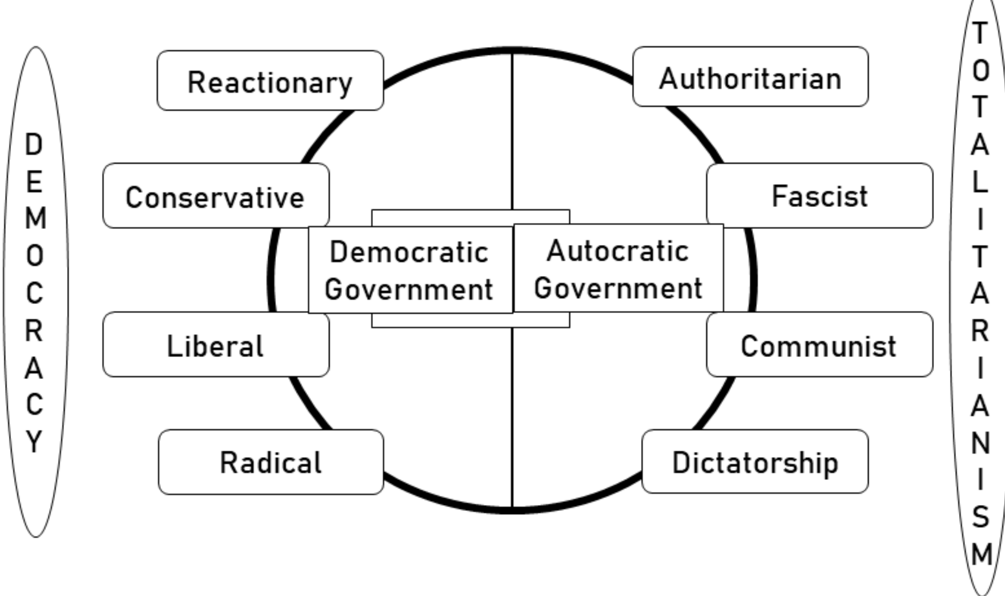
The doctrine of collectivism emphasizes the primacy of the collective over the interest of the individual. Collectivism in the business world holds that the ownership of assets, the allocation of resources, the structure of industries, the conduct of companies, and the actions of managers share a common goal, which started making decisions and conduct activities that improve the welfare of the collective.

Political Ideology

A political ideology encapsulates the doctrine of political behavior and change. A political ideology is a certain set of ethical ideals, 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.

The Political spectrum

In practice, purely democratic and totalitarian systems are exceptions. Looking around the world, one sees many variations. For example, democratic systems range from radical on one side (advocates of extreme political reform) to reactionary (advocates of a return to past conditions). Likewise, totalitarian systems emphasize the different degrees of state control. Fascism aims to control people’s minds, souls, and daily existence, whereas authoritarianism confines itself to political control of the state.



This could be easily understood with the help of an example. Let us take an example of an economy like India, in 2017, Transport Minister Mr. Nitin Gadkari shocked the automobile industry (and the world) when he announced that he intended for India to move to 100% electric cars by 2030.

He said at an industry conference "I am going to do this, whether you like it or not. And I am not going to ask you. I will bulldoze it."That was an ambitious target given that even the UK and France were hoping to phase out conventional combustion-engine cars only by 2040. The reason for such a move was a high dependency on fossil fuels and 21 of the 30 most polluted cities were from India then. This dependency on crude oil imports takes away a major portion of the total expenditure that the government of this country proposed to spend every year considering development. Due to which things do not work out the way the government of India planned things in the long run. On the crude oil front, the Indian government has started an initiative to blend ethanol and increase its blending limit to almost double. The enhanced capacity will help meet the government's target of 10% ethanol blending by 2022. This is likely to reduce the country's oil imports by 2 million tonnes annually and reduce the oil import bill by $ 1 Billion.

On the pollution front, the government has decided about electric vehicles but as such no policy was made. The impact of the announcement made by the government of India on the electric vehicle front can be seen from this aspect only that companies like Hyundai and MG motors started working on this front by making strategies to capture the market share in the electric vehicle.

Taking it further let us understand the initiative taken by a company like MG motors in the Indian market. Before we talk about the same let us go through some vital information about this company. Morris Garages was founded in the UK (95 years old) and is known for its classic sports cars. **MG** was acquired by China's state-owned Shanghai Automotive Industry Corporation in the late 2000s. MG Motor, the latest car brand to enter India, was trying to position itself as an innovation and technology leader in a bid to crack the market, which was dominated by Maruti Suzuki and Hyundai, who together account for 70 percent of all cars sold.

The company has already announced its product, MG ZS EV, an electric vehicle for the Indian market. MG Motor India was aware that India as a country was not yet ready for an electric car. India largely lacks in infrastructure required for electric vehicles to operate as one of the prerequisites charging stations.MG Motor India started working (with partners) to set up charging infrastructure and work on battery end-of-life strategy. Such positioning would make MG a force to reckon with in India and lay the foundation for its long-term plans, which include a possible entry into the small-car market. SAIC's parent company of MG in China started making a $1.5 billion investment in a state-of-the-art battery manufacturing facility, the first by a car manufacturer, which would help MG Hector when it comes to power the electric car that it has launched in India. It would help the company customize the battery for its models better and give a pricing advantage. This brings us to a very interesting aspect of this topic that is political risk.

Political Risk

It refers to the threat that decisions or events in a country will negatively affect the profitability and sustainability of an investment.

In continuation to the above example, the Indian government made a surprising U-turn on the electric vehicle policy. The government of India said it would not be mandatory by 2030 as India lacks infrastructure for the same. So, companies who have started investing taking into consideration the future aspect have to readjust their plan of action like MG motors and Hyundai concerning electric cars on Indian roads. Therefore, such things need to be managed by international business firms when operating in different geographic regions.

Classifying Political Risk

- Systemic
- Procedural
- Distributive
- Catastrophic

Systemic Political Risk:

A country's political processes aim not to punish companies arbitrarily. Rather investors commonly face the political risk that follows from shifting public policy. Newly elected officials, for instance, adopt policies that differ from their predecessors. Systemic political risk by influencing the macro business environment affects the business of all firms.

Procedural Political Risk:

It institutes impediments that constrain the flexibility of local operations. Political policies sometimes impose frictions that slow or stop these transactions. Corrupt officials for instance might pressure a firm to pay additional money to clear goods through customs. This risk is micro as it affects some but not all companies.

Distributive Political Risk:

It gradually eliminates the local property rights of foreign companies. If an MNE making better profits government tends to look for bigger cuts and in due course impose regulations that may create trouble for the operating firm.

Catastrophic Political Risk:

It devastates the business environment for all companies. It affects the operations of very firms in a country that arise from macro. An example could be a civil disorder or geopolitical dispute.

Types of Legal Systems

Common Laws:

It is developed by judges through the decisions of courts. It respects established case law in resolving disputes.

Civil Laws:

It is based on the strict application of statutory laws. It is the most widespread type of legal system.

Theocratic Laws:

It is based on the inspirations and instructions of religious teachings. Like Muslim law prevails in the Middle East and Northern Africa.

Customary Laws:

It is based on norms of behavior that gain legitimacy through ongoing practice. It prevails in many developing countries, particularly in Africa.

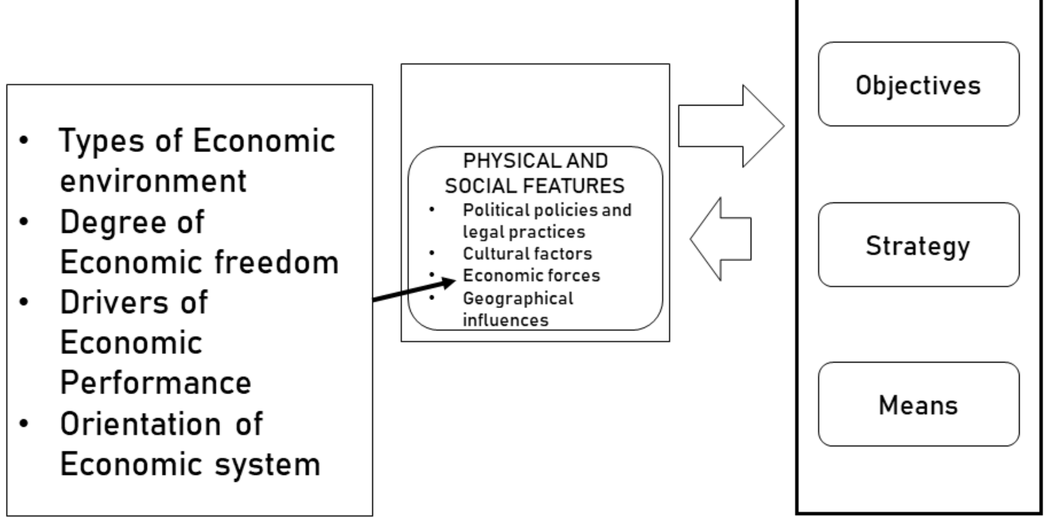
Mixed Legal:

This system results when a nation uses two or more of the preceding types, like Bangladesh, Singapore and Pakistan blend common and theocratic law.

2.3 Economic Factors

The world economy has changed profoundly since World War II. Perhaps the most fundamental change is the emergence of international markets; responding to new opportunities, international competitors have steadily displaced local ones. Concurrently, the integration of the world economy has increased significantly. Economic integration stood at 10 percent at the beginning of the 20th century, today it is approximately 50 percent. Integration is particularly striking in two regions, the European Union (formerly the European community) and the North American Free Trade Area.

Economic factors influencing International Business Operations



Economic factors talk about the type of economic environment in terms of its state of development, the economic freedom managers have to make investments and run operations, the orientation of the economic system that shapes its path of development, performance, and potential and the drivers of economic change, particularly the moderators of productivity, innovation, and competitiveness.

International Economic Analysis

The economic environment helps managers make better investment choices and operating decisions. Resource constraints require managers to identify which countries in the world warrant investment as well as those they must avoid. The world bank identifies 214 discrete economic environments in the world- 188 countries and 26 economies with a population of more than 30,000.

Resource constraints require managers to prioritize options, targeting markets that offer the greatest return with the least risk. It provides the analytical tools to determine the impact of an international company's operations on the economies of both host and home countries, as well as the impact of the host countries' economic environment on a foreign firm.

As per United Nations, based on a wide range of dimensions, it classifies a nation as a:

- Developed economy,
- Developing economy, and
- Economy in transition.

Developed Economy:

A developed economy has a robust economic environment marked by wide-ranging activities, efficient capital movement, stable institutions, extensive infrastructure, international trade and investment, advanced technologies, and higher economic freedom.

Developing Economy:

A developing economy has an uneven economic environment that is marked by narrow market activities, inefficient capital movement, resistance to foreign ownership, trade restrictions, imperfect

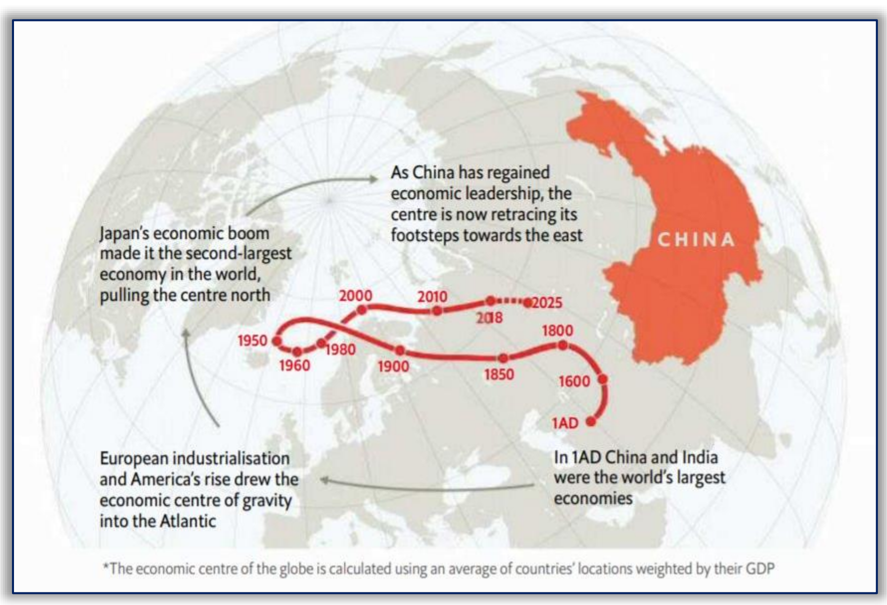
competition, unstable institutions, limited infrastructure, sketchy technologies, and lower economic freedom.UN has classified around 150 countries as developing.

Economy in Transition

Such economies are marred by fragile political institutions, heavy indebtedness, poorly performing markets, and ongoing conflicts. The term emerging economies is often used in place of economies in transition like Brazil, India, and China.

Gross world output increased nearly six-fold between 1970 and 2015, growing from $12 trillion to $78 trillion. In absolute terms, globalization expanded the economy for all. In relative terms, though, many countries prospered some more than others, and few not at all.

The Global Economy's Shifting Centre of Gravity



In 1980 the global economy's centre of gravity was mid-Atlantic. By 2008, from the continuing rise of China and the rest of East Asia, that centre of gravity had drifted to a location east of Helsinki and Bucharest. Extrapolating growth in almost 700 locations across Earth, the world's economic centre of gravity is projected to locate by 2050 literally between India and China. Observed from Earth's surface, that economic centre of gravity will shift from its 1980 location 9,300 km or 1.5 times the radius of the planet. If soft power mirrors but lags economic power, then the source for global and political influence will be similarly gradually shifting east over the next 50 - 100 years. Policy formulation for the entire global economy and global governance more generally, will no longer be the domain of the last century's rich countries but instead will require the more inclusive engagement of the east.

Economic Freedom

Economic freedom holds that one has the right to work, produce, consume, save, and invest in the way that one prefers. It measures the absence of government coercion or constraint on the production, distribution, or consumption of goods and services beyond the extent necessary for citizens to protect and maintain liberty.

Economic Freedom Index

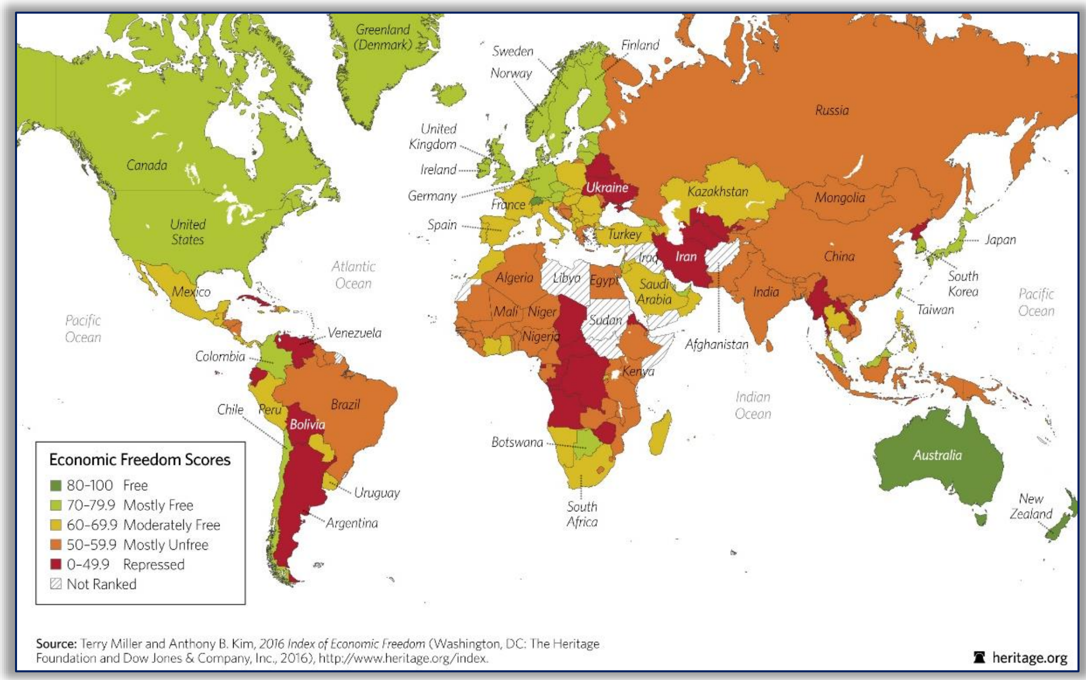
An index of economic freedom measures jurisdictions against each other in terms of trade freedom, tax burden, judicial effectiveness, and so on. It estimates economic freedom in a particular nation.

The dimensions of the economic freedom index include

- Rule of Law (property rights, government integrity, judicial effectiveness) If we understand in terms of property rights, the ability of individuals to accumulate private property, secured by clear laws that are fully enforced by the state.
- Government Size (government spending, tax burden, fiscal health) like tax burden imposed by the government.

- Regulatory Efficiency (business freedom, labor freedom, monetary freedom)- it covers aspects of the legal and policy framework that regulates the country's labor market.
- Open Markets (trade freedom, investment freedom, financial freedom) like in trade freedom- the absence of tariff and non-tariff barriers that affect imports and exports of goods and services.

The Presence and Prevalence of Economic Freedom



Economies rated "free" or "mostly free" in the Index enjoy incomes that are more than twice the average levels in all other countries and more than five times higher than the incomes of "repressed" economies. Economic freedom is closely related to openness and limited government, advancing entrepreneurial activity. Given this relationship, it should be apparent that a government's most effective stimulus activity is not increasing its spending or putting in place more layers of regulation, both of which reduce economic freedom. The best results are often achieved instead through policy reforms that limit the size of government and create greater economic dynamism in the private sector.

Economically freer countries that open their societies to new ideas, products, and innovations have largely achieved high levels of social progress. It is not massive redistributions of wealth or government dictates that produce the most positive social outcomes. Instead, mobility and progress require lower barriers to market entry, freedom to engage with the world, and less government intrusion. In other words, those who believe in economic freedom believe in the right of individuals to decide for themselves how to direct their lives. The added benefit from society's point of view is the proven power of self-directed individuals, whether working alone or working together in associations or corporations, to create the goods and services that best respond to the needs and desires of their fellow citizens.

No country provides perfect freedom to its citizens, and those that do permit high levels of freedom differ concerning which aspects they believe are most important. That is consistent with the nature of liberty, which allows individuals and societies to craft their unique paths to prosperity.

Types of Economic Systems

Command	Mixed	Market
• Government owns most or all resources • Advocates centralized, large scale, capital intensive production. • Applies the visible hand of the state, central planning and collectivism • Philosophical anchor: Communism	• Govt and private ownership of economic resources mixed in varying proportion. • Advocates optimizing economic efficiency, promoting egalitarianism, and pre-empting self interest. • Philosophical anchor: Socialism	• Mostly private ownership of resources. • Advocates decentralized, entrepreneurial innovation. • Applies the invisible hand, property rights and individualism. • Philosophical anchor: Capitalism

Low ← Degree of Economic Freedom → High

Command Economy:

The state owns and controls the factors of production. Public officials and not private agents, decide what products to make, in what quantity, at what price, and in what way. Examples: China, Russia, and Saudi Arabia. The philosophical anchor for such an economy is communism.

Mixed Economy:

It falls between the market and command types. It is a system in which economic decisions are principally market-driven and ownership is largely private, but the government intervenes, from a little to a lot, in valuing assets, allocating resources, regulating activities, and organizing the market. Examples: Japan, South Kore, Brazil, and India. The philosophical anchor for such an economy is socialism.

Market Economy:

It is a system whereby individuals, rather than government, make most of the decisions. Optimal resource allocation follows from consumers exercising their freedom of choice and producers responding accordingly. This economy is commonly found in developed economies like the US, Australia, and Canada. The philosophical anchor for such an economy is capitalism.

Economic Environment Indicators

- Interest rates
- Inflation
- Gross National Income (GNI)
- Gross Domestic Product (GDP)
- Gross National Product (GNP)
- Exchange Rates
- International trade (Surplus)

Gross national income, GDP, or GNP, efficiently summarizes the economic activity of households, businesses, and governments in terms of their consumption, investment, spending, and trading. These indicators need to be managed by the policymaker in the right way otherwise it leads to various serious issues like seen in Venezuela, Zimbabwe, and others. We will be covering the example of Venezuela for a better understanding of the same.

Let us begin with the timeline of the crisis in Venezuela

- 1920s to 1970s: Oil is discovered in Venezuela, which is found to have the world's largest reserves. The nation's economic development is based on rising prices and profits in oil exports.
- 1980s to 1990s: Global oil prices fall; Venezuela's economy contracts. The country faces massive debt.
- 1998: Hugo Chavez, former leader of a 1992 coup attempt, is elected president. He promises to use the country's oil wealth to improve the lives of the poor.
- 2000s: Chavez expands social services, but corruption is rampant, and a steady decline in oil production reduces oil reserves and increases government debt.
- 2010 to 2012: Chavez's attempt at economic reform like currency devaluation and price controls are ineffective.
- 2013: With inflation at more than 50% a year, the National Assembly gives Maduro emergency power for a year, beginning in November.
- 2014: Public spending is curtailed because of low oil prices. Anti-government protests are broken up with force.
- 2015: the opposition Democratic Unity party wins control of the National Assembly, ending 16 years of Socialist Party rule.
- 2016: The economy is in crisis, and the healthcare system lacks funding. Hunger and malnutrition, maternal and child mortality, infectious diseases, and unemployment increase alarmingly.

We can see from this. when economic indicators are overlooked by the policymaker in a country such situations can take place. Venezuela's hyperinflation rate increased from 9,02 percent to 10 million percent since 2018, according to the International Monetary Fund, though it is expected to decline to back below 1 million percent due to some moves by the country's central bank, such a situation would not attract any FDI. Shock therapy measures, based on recent economic history, can include ending price controls and government subsidies, instituting higher tax rates and lower government spending to reduce budget deficits, devaluing the currency to boost foreign investments, and selling state-owned industries to the private sector. These are some of the measures that were available to the policymakers to manage the situation.

Venezuela will have to transform its current scheme of restricting foreign investment to fund the restoration of the energy sector, as well as its infrastructure, including the country's roads and bridges and the power grid. Besides foreign investment, Venezuela will likely need help from multinational institutions such as the World Bank, the Inter-American Development Bank, and the Development Bank of Latin America to fund infrastructure development. The lack of human capital is another issue Venezuela will have to address to recover from its economic crisis. Venezuela has lost more than 10% of its population in recent years. The number of Venezuelan migrants and refugees has reached 4 million and is expected to surpass 5.3 million by the end of this year, according to the U.N. Refugee Agency. What we see here is a catastrophic effect on one issue leading into others and creating an unsustainable situation.

We try to compare the inflationary situation through purchasing power parity in Venezuela. One cup of coffee in Venezuela may cost 1 hundred thousand US dollars, comparing it with the US it will cost only $3. This example reflects the importance of managing the economic indicator in the desired range for better managing the economies. Accordingly, multinational companies can review the status of a particular economy before entering into it with the help of these economic indicators.

Shadow Economy

The shadow economy includes not only illegal activities but also unreported income from the production of legal goods and services, either from monetary or barter transactions. It includes extra-legal activities as well as illegal doings that fall beyond official statistics. It is also known as black, grey, or parallel market or the informal economy.

Example: Counterfeit products market in Indian Economy

Counterfeit products have created around $14 billion hole in the Indian economy. Counterfeiting is a universal issue and is 3.3 percent of global trade, according to the organization of economic cooperation and development data, impacting social and economic development across the world. It includes the currency, FMCG, alcohol, pharma, documents, agriculture, infrastructure, automotive, tobacco, lifestyle, and apparel, as the 10 sectors impacted most by counterfeiting. Among these, currency, alcohol, and FMCG continue to be the top three sectors with the highest counterfeiting in the last two years in India. This is an example of a shadow economy.

Important Indices for Economic Environment

1. **Global Competitive Index**

The world economic forum holds that providing increasing prosperity hinges on how well a country develops institutions, regulates activities, and uses resources to improve productivity. A country's proficiency in managing these domains determines its international competitiveness. GCI taps dimensions like financial market development, macroeconomic environment, technological readiness, market efficiency, and innovation.

2. Global Innovation Index

Countries increasingly look to brainpower for innovations that boost productivity, fortify competitiveness, and increase prosperity. The growing power of ideas and insights in the global market makes a country's capacity for innovation a key determinant of its economic performance and potential.GII estimates a nation's capacity to imagine ideas, leverage them into pioneering products, and, in the process, generate knowledge, competitiveness, and wealth.

3. The World Competitiveness Index

The world competitiveness project assesses a nation's ability to set and sustain a business environment that enables enterprises to compete, prosper, and create wealth. Four factors determine a nation's competitiveness such as economic performance, business efficiency, government and efficiency, and infrastructure. It helps WCI to summarize a nation's performance.

4. The-Where-To-Be-Born Index

It holds that how well a country provides opportunities for a healthy, safe, and prosperous life helps explain both its current and future economic environment.

The economic environment factor plays a very crucial role for multinational firms where they operate in international geographies as is being seen in this section of the unit.

2.4 Technological Factors

Technological factors are variables that are being used for evaluating available alternatives concerning technological capabilities. Multinational companies consider it an important tool for improving operations and functions. Technological factors are one of the various external environmental factors that affect businesses greatly and are also an integral component of the PESTLE analysis. In the present scenario, utmost dependence on equipment, technological factors can have more effect on business operation and success globally than ever before. The technological environment of business has changed how businesses function. Advancements in information technology have almost taken over every department of the organization. Now, information is stored in data servers and cloud technology as against the old way of storing data in registers and files.

Furthermore, the development of technology has also introduced digital marketing strategies through which companies can sell their products and services. Even the research and development R&D divisions in companies have changed their way of functioning and more advanced techniques in the development of products and services have been introduced only through technological advancements.

The impact of technological factors on international business operations can be seen in this section in three different interesting scenarios. The first scenario will cover the proactive approach where we will see how the countries are trying to stay relevant to the changing scenarios by updating themselves to the changing technologies. In the second scenario, we will discuss the impact of being reluctant to bring change with time in the technological up-gradation of the organization's

operations. In the final scenario, we will see if the technology is such which is not able to find a target market can also lead to failure.

Technological Factors influencing International Business operations

These factors consider the rate of technological innovation and development that could affect a market or industry. Factors could include

- changes in information and communication technology,
- automation,
- research and development.

There is often a tendency to focus on developments only in digital technology, but consideration must also be given to new methods of distribution, manufacturing, and also logistics. Technological factors have a critical macro-economic influence on a business's operations, its products, how it delivers its services, and even its markets.

Disruptive Technologies

Disruptive technology is an innovation that significantly alters the way that consumers, industries, or businesses operate. A disruptive technology sweeps away the systems or habits it replaces because it has recognizably superior attributes. Let us understand the first scenario with the help of the example mentioned below.

Saudi Arabia is going to invest $20 Billion in artificial intelligence by 2030.

A country like Saudi Arabia whose government relies on crude oil for its revenue generation is looking to invest in a disruptive technology like artificial intelligence. It Stated that shares will be open to both foreign and local investors, as the country seeks to establish more than 300 start-ups in artificial intelligence by 2030. Like most countries in the energy-rich Gulf, Saudi Arabia has been trying to diversify its economy which has been hit by the double whammy of low oil prices and the coronavirus pandemic. So the country's policymakers are taking proactive measures to create an alternative source of income for their country.

Now let us understand this disruptive technology i.e. artificial intelligence and machine impact on multinational firms and how its adoption is creating an opportunity for companies that looking to expand their footprint at the global level.

Artificial Intelligence and Machine Learning

It refers to the ability of machines to learn and act intelligently – meaning they can make decisions, carry out tasks, and even predict future outcomes based on what they learn from data.AI and machine learning already play a bigger role in our everyday life of ours than you might imagine. Alexa, Siri, Amazon's product recommendations, Netflix's and Spotify's personalized recommendations, every Google search you make, security checks for fraudulent credit card purchases, dating apps, fitness trackers, all are driven by AI.

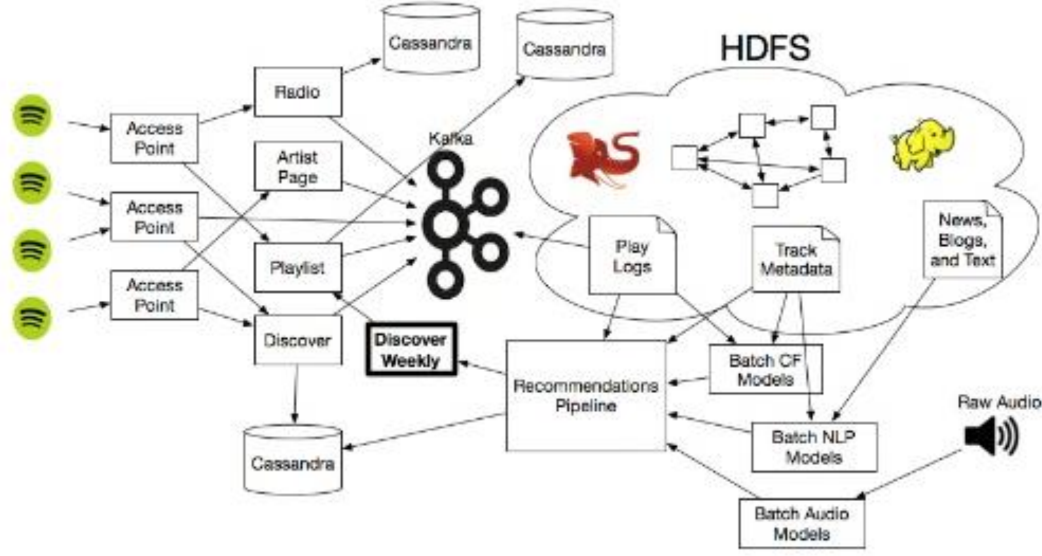
Case Study: Spotify

Spotify is the largest on-demand music service application today. The firm has a record of pushing boundaries in technology by using AI and machine learning to enhance the user experience through nuanced customer data insights. They've recently acquired several data science companies to further push the envelope, ensuring they remain at the forefront of the music streaming world.

Now the question arises how AI works in music streaming companies and how it has been proactively taken up by Spotify to capture a large chunk of the target market. With tens of millions of users listening to music every minute of the day, brands like Spotify accumulate a mountain of implicit customer data comprised of song preferences, keyword preferences, playlist data, geographic location of listeners, most used devices, and more.

Data drives decisions across every department at Spotify. This information is used to train algorithms that extrapolate relevant insights both from content on the platform and from online conversations about music and artists, as well as from customer data, and use this to enhance the user experience. One example is 'Discover Weekly', which reached 40 million people in the first year it was introduced. Each Monday individual users are presented with a customized list of thirty songs. The recommended playlist comprises tracks that users might have not heard before, but the recommendations are generated based on the user's search history pattern and potential music preference. Machine learning enables the recommendations to improve over time. Not only does it keep users returning, it also enables greater exposure for artists who users may not search for organically.

Discover weekly data flow chart below helps in understanding the information flow that is taking place while creating a playlist for the user in a customized manner.



Discover Weekly Data Flow

For Spotify to generate the 'Discover Weekly' personalized music list, the team uses a combination of three models:

- Collaborative Filtering
- Natural Language Processing (NLP)
- Audio models

Collaborative filtering involves comparing a user's behavioral trends with those of other users. Content streaming platform Netflix similarly adopts collaborative filtering to power their

recommendation models, using viewers' star-based movie ratings to create recommendations for other similar users.

While Spotify doesn't incorporate a rating system for songs, it does use implicit feedback like the number of times a user has played a particular song, saved a song to their lists, or clicked on the artist's page upon listening to the song to provide relevant recommendations for other users that have been deemed similar.

Natural Language Processing (NLP) model analyses human speech via text. Spotify's AI scans a track's metadata, as well as blog posts and discussions about specific musicians, and news articles about songs or artists on the internet. It looks at what people are saying about certain artists or songs and the language being used, and also which other artists and songs are being discussed alongside, if at all, and identifies descriptive terms, noun phrases, and other texts associated with those songs or artists. These keywords are then categorized into "top terms". Every artist and song is associated with thousands of top terms that are subject to change daily. Each term is assigned a weight, reflecting its relative importance in terms of how many times an individual would attribute that term to a song or musician they like.

Spotify doesn't have a fixed dictionary for this, but the system can identify new music terms as and when they come up – not just in English, but also in Latin-derived languages across cultures.

n2 Term	Score	np Term	Score	adj Term	Score
dancing queen	0.0707	dancing queen	0.0875	perky	0.8157
mamma mia	0.0622	mamma mia	0.0553	nonviolent	0.7178
disco era	0.0346	benny	0.0399	swedish	0.2991
winner takes	0.0307	chess	0.0390	international	0.2010
chance on	0.0297	its chorus	0.0389	inner	0.1776
swedish pop	0.0296	vous	0.0382	consistent	0.1508
my my	0.0290	the invitations	0.0377	bitter	0.0871
s enduring	0.0287	voulez	0.0377	classified	0.0735
and gimme	0.0280	something's	0.0374	junior	0.0664
enduring appeal	0.0280	priscilla	0.0369	produced	0.0616

Cultural Vectors and Top Terms with respective assigned weights
Source:https://notes.variogr.am/2012/12/11/how-music-recommendation-works-and-doesnt-work/

Audio models are used to analyze data from raw audio tracks and categorize songs accordingly. This helps the platform evaluate all songs to create recommendations, regardless of coverage online. For instance, if there is a new song released by a new artist on the platform, NLP models might not pick up on it if coverage online and on social media is low. By leveraging song data from audio models, however, the collaborative filtering model will be able to analyze the track and recommend it to similar users alongside other more popular songs.

In this way, Spotify portrays itself not just as a platform for popular existing musicians, but also one that provides opportunities for the next generation of budding musicians to gain recognition. Spotify has reported total revenue of **$7.44 billion** in 2019. Announced on February 5th, as part of the streaming giants for the record financial performance report, Spotify revealed they had made total revenue of **$7.44 billion** last year, an increase of 29% when compared to 2018.

This is an example of the adoption of disruptive technologies and getting an edge over the competitors by adopting the latest disruption at the right time but this does not happen always and sometimes companies remain reluctant to adapt to the latest disruption and pay a heavy price for the same later. This can even have the reference as an example of Kodak from the previous unit.

Let us understand the second scenario now with the help of an example.

From market domination to sell-off in less than 10 years, as Microsoft swoops in to buy Nokia's mobile business for £4.6bn, what happened to Finland's most beloved firm. Whenever you turned on one of Nokia's legendary handsets, you always got the same thing like the famous signature logo, holding hands.

Nokia was by no means the first company to release a commercially available mobile phone, but it was the first to do it well, and with true mass appeal. Nokia was so dominant. People didn't talk about what brand, it was just about the number, 3210, or whatever you had. Then all of a sudden, in January 2007, Steve Jobs walked on to a stage and pulled an iPhone out of his pocket and changed the world forever. The fall was swift. According to figures from analyst firm Gartner, Nokia's Smartphone market share in 2007 was a dominant 49.4%. In subsequent years, it was 43.7%, then 41.1%, then 34.2%.In the first half of 2012, it had plummeted to just 3%. Nokia makes great phones, they still do. They went through this incredible decade of innovation in hardware, but what Apple saw was that all you needed was a rectangle with a screen, and the rest was all about the software, where Nokia fail to adapt miserably. This reflects the importance of technology adoption at the right time for surviving in the industry while taking note of the change in the environment.

The Third scenario talks about where technology innovation was commercialized without considering the need of the market. This can be well understood by the following example.

Dean Kamen, the self-balancing scooter's inventor, previously invented a robotic wheelchair that could climb stairs. Before it launched, the Segway was said to revolutionize the way cities are laid out and how people get around them. It was predicted that it would reach $1 billion in sales, faster than any company in history, and that it could be bigger than the Internet. Kamen is expected to be selling 10,000 units a week by the end of 2002—that's half a million a year. In the next six years, Segway sold just 30,000 units.

The Segway worked as advertised, but it was awkward to use. It was small enough to ride inside a building or into an elevator, but at 100 pounds, it was too heavy to carry upstairs. It also required the rider to be "that guy" (and it was almost always a guy), rolling his electric scooter around the lobby and corridors of his office building. And then you need to park it.

It's hard enough to get cities to embrace the bicycle, something that's been around for a century and a half, and to design their streets around it. And, though many bikers look ridiculous in their skin-tight racing outfits, at least they're getting a workout. The Segway was perhaps the laziest mode of transportation around. "People just didn't know what to make of it. It was never truly socially accepted. If companies are not able to access the need of the target market in the right manner then technology innovation might not work for such organizations.

All the factors in the operating environment impact the functioning of international business firms. We have seen various examples for factors such as cultural, political, legal, economic, and technological. These factors constitute the external environment in which multinational firms operate. External factors are beyond the control of the organization therefore, there are supposed to adjust the business as per changes taking place through these factors.

The operating environment can also be seen through PESTLE analysis as it covers all external environment factors. It helps in providing information to the companies about the external environment and accordingly, companies can adjust their strategies while taking care of it.

Summary

This unit attempts to provide information on the impact of various external factors on multinational firms while operating internationally.

The operating environment includes political, social, legislative, economic, cultural, and natural environmental factors that significantly affect the business of any international firm.

International companies should be aware of predominant attitudes, values, and beliefs in each host country were decided to expand their business activities.

Values and norms are influenced by political and economical philosophy, social structure, religion, language, and education.

Culture is not a constant; it evolves. Economic progress and globalization seem to be two important engines of cultural change.

Technology has removed the global barriers like distance, time, etc thanks to the latest technological developments like the Internet, e-mail, video conferencing, cell phone, etc that play a major role in international business.

Disruptive technology is an innovation that significantly alters the way that consumers, industries, or businesses operate.

Economic freedom holds that one has the right to work, produce, consume, save, and invest in the way that one prefers.

The economic environment helps managers make better investment choices and operating decisions.

The shadow economy includes not only illegal activities but also unreported income from the production of legal goods and services, either from monetary or barter transactions. It includes extra-legal activities as well as illegal doings that fall beyond official statistics. It is also known as black, grey, or parallel market or the informal economy.

Keywords

Power Distance: It is a measurement of employee preferences of interaction between superiors and subordinates.

Polycentrism: It may be the overly cautious response to cultural variety, causing a firm to shy away from certain countries or avoid transferring home-practices or resources that will work well abroad.

Artificial Intelligence: It refers to the ability of machines to learn and act intelligently – meaning they can make decisions, carry out tasks, and even predict future outcomes based on what they

learn from data.AI and machine learning already plays a bigger role in everyday life of ours than you might imagine.

Shadow Economy: It includes not only illegal activities but also unreported income from the production of legal goods and services, either from monetary or barter transactions.

Developed economy: It has a robust economic environment marked by wide-ranging activities, efficient capital movement, stable institutions, extensive infrastructure, international trade and investment, advanced technologies, and higher economic freedom.

Command Economy: The state owns and controls the factors of production. Public officials and not private agents, decide what products to make, in what quantity, at what price, and in what way.

Distributive Political Risk: It gradually eliminates the local property rights of foreign companies. If an MNE making better profits government tends to look for bigger cuts and in due course impose regulations that may create trouble for the operating firm.

Market Economy: It is a system whereby individuals, rather than government, make most of the decisions. Optimal resource allocation follows from consumers exercising their freedom of choice and producers responding accordingly.

Theocratic Laws: It is based on the inspirations and instructions of religious teachings. Like Muslim law prevails in the Middle East and Northern Africa.

Self-Assessment

1) ________ consists of specific learned norms based on attitudes, values, and beliefs of a group of people.
   a) Ethnology
   b) Civilization
   c) Culture
   d) Doctrine

2) Which of the following is NOT true about cultural diversity?
   a) Companies may gain competitive advantages by bringing together people of diverse backgrounds.
   b) Cultural diversity is most successful when domestic and foreign firms establish joint ventures.
   c) Cultural diversity may help a company gain deeper knowledge about products and services.
   d) The process of bringing people of different national cultures together is often difficult.

3) The nation offers a workable reference for studying cultural differences because ________.
   a) a nation contains only one distinct culture
   b) similarity among people is both a cause and effect of national boundaries
   c) the commonality of language within a nation eases the process of conducting surveys
   d) different groups within the same country always have more in common with each other than with groups in other countries

4) Most people's basic value system is ________.
   a) modified significantly between childhood and adulthood
   b) altered during adulthood through the imposition
   c) affected primarily by teenage peer pressure
   d) acquired mainly during early childhood

5) People generally prefer little consultation between superiors and subordinates in cultures where ________ is high.
   a) power distance
   b) fatalism
   c) individualism
   d) self-actualization

6) All of the following countries have a totalitarian political system EXCEPT ________.

a) China
b) Russia
c) South Korea
d) Saudi Arabia

7) The principle that an individual has the freedom to pursue his or her interests is called ________.

a) socialism
b) totalitarianism
c) individualism
d) collectivism

8) Proponents of ________ argue that individual interests are not as important as the welfare of the group.

a) pluralism
b) capitalism
c) collectivism
d) individualism

9) In a country that emphasizes collectivism, ________.

a) the interests of the individual are more important than the interests of the state
b) one person or political party exercises absolute control over the political and economic systems
c) the needs of society and the needs of individuals are treated as equally important
d) the needs of society take precedence over individual freedoms

10) ________ refers to a political system in which government is organized by and accountable to the people.

a) Totalitarianism
b) Fascism
c) Socialism
d) Democracy

11. Kyle, an international manager for Apex Industries, has been given the task of analyzing the economies of three different emerging countries for the firm's potential expansion. Which of the following questions is LEAST relevant to Kyle's assignment?

a) How much freedom will Apex have to run its foreign operations?
b) What are the current economic policies related to development?
c) What is the likelihood that Apex can fill manufacturing positions with locals?
d) What factors in the country drive or hinder economic change?

12. Since the late 1980s, the growing emergence of freer markets has been powered by the realization that ________.

a) economic growth is directly related to economic freedom
b) economic growth has a limited effect on the standard of living
c) adoption of free market principles contributes to social injustices
d) centrally planned economies are best designed to deliver progress

13. In a command economy, ________.

a) businesses and consumers are assumed to be the best judges of how resources should be allocated
b) the government sets goals and determines the price and quantity of what is produced

c) different economic sectors coordinate the activities of the federal government

d) each enterprise sets its goals before making reports to the central government

14. Williams Enterprises wants to expand its operations into Asia. Managers are focusing on countries with high degrees of economic freedom most likely because the firm is interested in a country with ________.

a) minimal government intervention

b) standardized minimum wages

c) laws favoring sustainability

d) state-run corporations

15. Tatum Manufacturing recently opened a new facility in Hong Kong. The firm can most likely expect the Hong Kong government to ________.

a) monitor market prices

b) control natural resources

c) ensure fair competition

d) provide innovation incentives

16) Which of the following is not a technological factor influencing international business operation?

a) Change in technology

b) Research and development

c) Automation

d) Inflation

17) Technology has drastically reduced time between conceiving an idea and ___________ that idea.

a) Processing

b) Implementing

c) Generating

d) None of these

18) Which of the following countries has a collectivist orientation?

a) Canada

b) Australia

c) Japan

d) Netherlands

19) Which of the following is most likely a characteristic of a "partly free" country, such as Guatemala, Pakistan, or Tanzania?

a) strict religious constraints

b) fair election procedures

c) respect for civil liberties

d) weak rule of law

20) In which of the following countries would business activity, given its status as a "not free" marketplace, be under the greatest government control?

a) Vietnam

b) Pakistan

c) India

d) Brazil

Answer for Self Assessment

1.	C	2.	B	3.	B	4.	D	5.	A
6.	C	7.	C	8.	C	9.	D	10.	D
11.	C	12.	A	13.	B	14.	A	15.	C
16.	D	17.	B	18.	C	19	D	20.	A

Review Questions

1. What are the advantages and disadvantages of using a nation as a point of reference for a culture?

2. What are the characteristics of individualist and collectivist cultures?

3. What is the difference between a polycentric, ethnocentric, and geocentric approach to international management? What key factors should a firm consider before adopting one of these approaches?

4. What is the difference between individualism and collectivism? What is the relationship between government and business under each orientation?

5. What are the differences between democratic and totalitarian political systems?

6. What is procedural political risk? How does a nation's political and legal environment influence procedural risk for MNEs?

7. Contrast common law, civil law, customary law, and theocratic law.

8. Why is economic freedom an important factor to consider when analyzing a country's economic development, performance, and potential?

9. What is state capitalism? Why do you think state capitalism is becoming increasingly popular around the world?

10. Do you think technological factors influencing international business operations? Justify.

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UNIT 03: The External Environment and Challenges

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Objectives

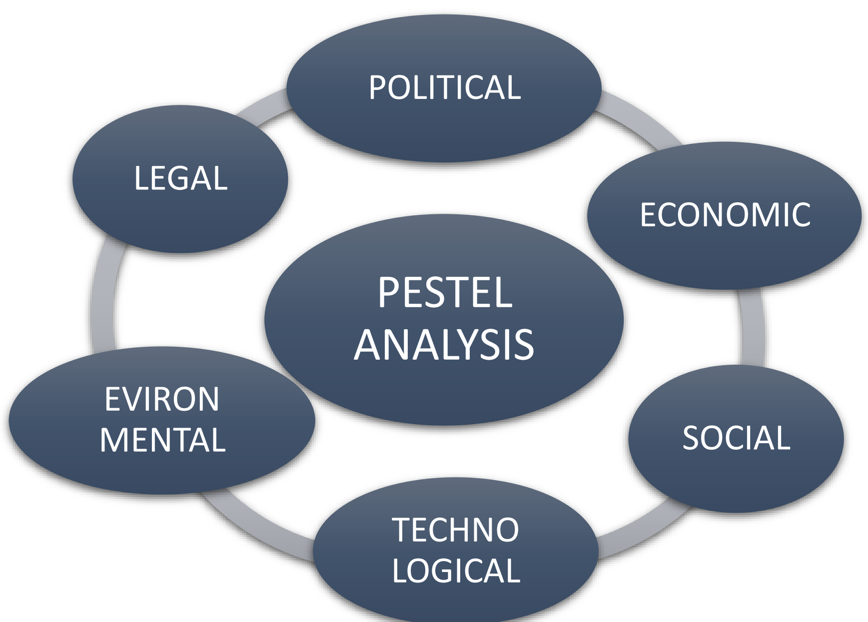
After studying this unit, you should be able to

- Classify the various types of risks while undertaking an international assignment.
- Illustrate recent world trade and foreign investment trends.
- Analyze environmental influence on trade and investment patterns.

Introduction

International business entails greater complexity in both organization and strategy than the national or local firm. Businesses seeking to expand internationally find that a diversity of national environments presents a host of challenges, extending across economic, political, legal, and cultural dimensions. Businesses that are entrepreneurial and international in their thinking from the outset are often better placed to take advantage of new opportunities, particularly in the internet and high-tech sectors, than established companies dominated by their home-country culture. SMEs increasingly play vital roles in international business.

We will begin this unit with a famous quote by Mr. Gary Cohn. He said, "If you don't invest in risk management, it doesn't matter which business you are in, it's a risky business." The relevance of the same can be throughout this unit. The risk profile of international business differs significantly from companies operating in domestic markets. There are different kinds of risks associated with international business. Risks are more difficult to identify, changes can be more rapid than anticipated and the effects are massive. Dependency in international business is inevitable. Companies can hardly implement international business activities just by themselves; they need different kinds of cooperation with other companies that bring additional input to their risk profile. A PESTEL analysis is an acronym for a tool used to identify the macro (external) forces facing an organization. Depending on the organization, it can be reduced to PEST or some areas can be added (e.g. Ethical).



3.1 The risk associated with International Business

There are many risks in which companies can manage by implementing activities to eliminate, decrease, transfer or avoid the risk. Like risks related to innovation, reputation, people, price, and cost-cutting are examples of this kind of risk. Companies need to know, what risks they can live with, what risks they need to manage and avoid to be able to implement their strategy. Effective risk management practices provide answers and means to implement these. The risks associated with the international business are:

- Weak Economies
- Regulatory Risks
- Increasing Competition
- Damage to Reputation
- Failure to attract top talent
- Failure to Innovate
- Commodity Price Risk
- Cashflow & Liquidity Risk
- Political Risk
- Disruptive Technologies

Let us understand the impact of the above-mentioned risks with the help of the example.

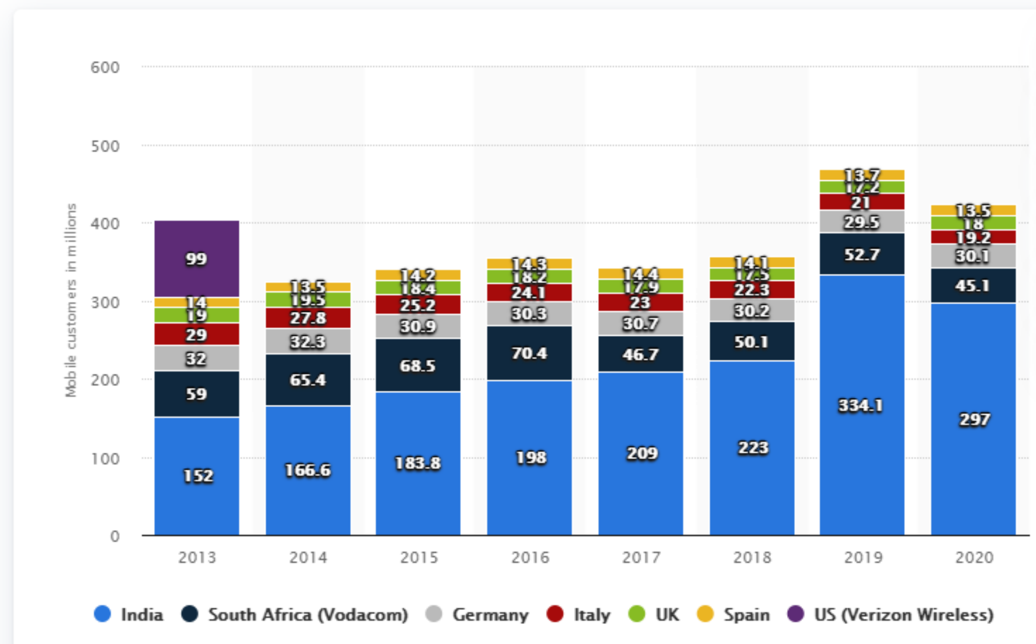
Example: Vodafone India

Vodafone is a telecommunications company based in the United Kingdom. It originated as part of Racal, a British radar and electronics firm founded in 1950. Racal founded its Vodafone subsidiary in 1983 and won the license to build Britain's first cellular telephone network, which was launched in 1985. By the early 1990s, Vodafone was purchasing other companies and building network partnerships around the world.

Vodafone is the largest mobile and fixed network operator in Europe is the world's largest IoT connectivity provider. It operates mobile and fixed networks in 22 countries and partners with mobile networks in 48 more. Vodafone group revenue stands around €45 billion during fiscal 2020. Looking at the above-mentioned statistics and information, it appears that this organization is doing fairly well globally. But if we consider its one of the subsidiary Vodafone India, the situation reversed.

It made its first tentative move in the country in 2005 by picking up a minority 10 percent in Bharti Airtel, which many thought was the beginning of a new relationship. But the company was not looking to play a minority investor, and the opportunity came knocking with the Hutchison-Essar acquisition. For this deal, Vodafone had to make a substantial payout, which, apart from buying out Hutchison, was followed up by buying the other partners in the company. The total was a steep £9.4 billion in 2007.

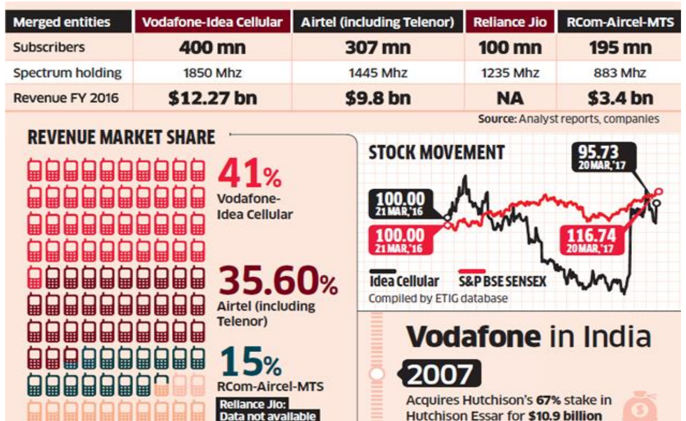
Just a few years after Vodafone's entry, the Congress-led government in India disrupted the market by allowing new entrants on a first-come-first-served basis increasing the number of players from around six to more than 12, pushing down tariffs to unsustainable levels. But they were hit by yet another disruption, which was more severe. In September 2016, Reliance Jio entered the market; offering initially free service followed by rock-bottom tariffs (free voice for the first time) as well as cheap data powered by a brand new 4G network, which none of the rivals could match. It also backed it up by giving 4G feature phones, again at nominal prices, while competitors like Vodafone India Limited had no matching offer. The onslaught has continued, hitting VIL the most among incumbents as it has consistently lost both markets as well as revenue share to its rivals, especially Jio. This reflects the risk of increasing competition for the company in the international market. But still, Vodafone continued its operation as we can see the number of subscribers for Indian subsidiaries from the chart below remained the highest among various prominent markets where Vodafone is operating.



Number of Vodafone mobile customers from 2013 to 2020, by country/market *(in millions)*

The Jio attack also came at a difficult time, just when Vodafone India Limited (VIL) was going through the process of integrating its networks, which would take time to bring in cost savings. The

shareholders put in more money through debt as well as through a fresh rights issue (which Vodafone subscribed) to finance upgrading its legacy network to 4G and face the Jio challenge. The entire telecom sector in India started looking for consolidation. Vodafone India also saw that it might be difficult for the company to survive in long run, therefore VIL thought of merging its operations with Idea cellular. The figure below depicts how this merger would have helped the VIL to consolidate its position in the market.



Merged entities	Vodafone-Idea Cellular	Airtel (including Telenor)	Reliance Jio	RCom-Aircel-MTS
Subscribers	400 mn	307 mn	100 mn	195 mn
Spectrum holding	1850 Mhz	1445 Mhz	1235 Mhz	883 Mhz
Revenue FY 2016	$12.27 bn	$9.8 bn	NA	$3.4 bn

Source: Analyst reports, companies

Even after consolidation in the telecom sector in India situation did not become comfortable for the operating companies. Vodafone-Idea debt soared to 20x of EBIDTA and cash losses hit over Rs 51 billion in the first quarter of FY20 even as revenue declined. What adds to CEO's worries was the Supreme Court judgment, which has directed the telcos to pay their outstanding amount within three months. This reflects the regulatory risk on the international companies.

The Supreme Court handing down a judgment under which Vodafone Idea Ltd (VIL) had to fork out Rs 28,308 crore as adjusted gross revenue (spectrum usage charges would be extra), which was nearly equivalent to the EBIDTA of all operating telcos together in FY19. It leads this joint venture to a very precarious situation and Indian joint venture Vodafone Idea was moving towards a "liquidation scenario" if the government did not give the company immediate financial relief.

Even after 12 years since the company has entered the Indian market, the company strategy to bring the company to the world's fastest-growing markets has not only drained Vodafone's financial resources but has not given any return to its shareholders. Cut-throat competition, high spectrum costs, and frequent flip-flops in Indian government policies have made it difficult for Vodafone to make money in the country.

The example above reflects the impact of various types of risks that an organization needs to deal with once it enters an international market.

3.2 Recent World Trade & Foreign Investment Trends

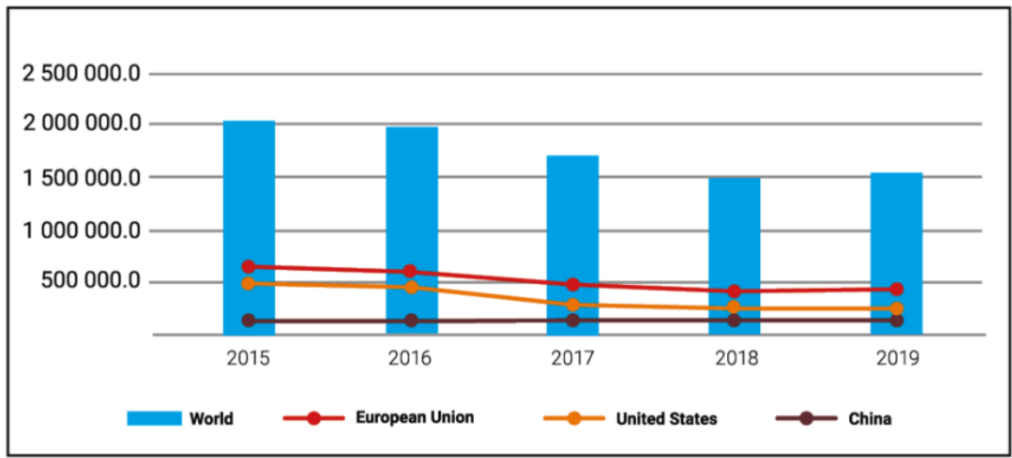
FDI has grown substantially since the 1970s as governments have liberalized their markets and introduced measures to facilitate foreign investment. The growth in foreign investment was especially marked from the mid-2000s onwards as countries sought to encourage cross-border investment, improve competitiveness, and foster growth. The upward trend in FDI came to a sharp but temporary end with the financial crisis.

Over the past two decades countries have followed a liberalized approach towards FDI and have put in place international investment protection rules to benefit foreign investors. However, in the past few years, FDI protectionism has been on the rise, with a screening of inward investments becoming more frequent, as countries have been re-evaluating their approach.

Historically, FDI screening mechanisms have been sector-specific and strongly focused on the defense industry and critical domestic infrastructure. However, governments have started to identify new threats to national security as societies become ever more technology-dependent and vulnerabilities in the technology emerge.

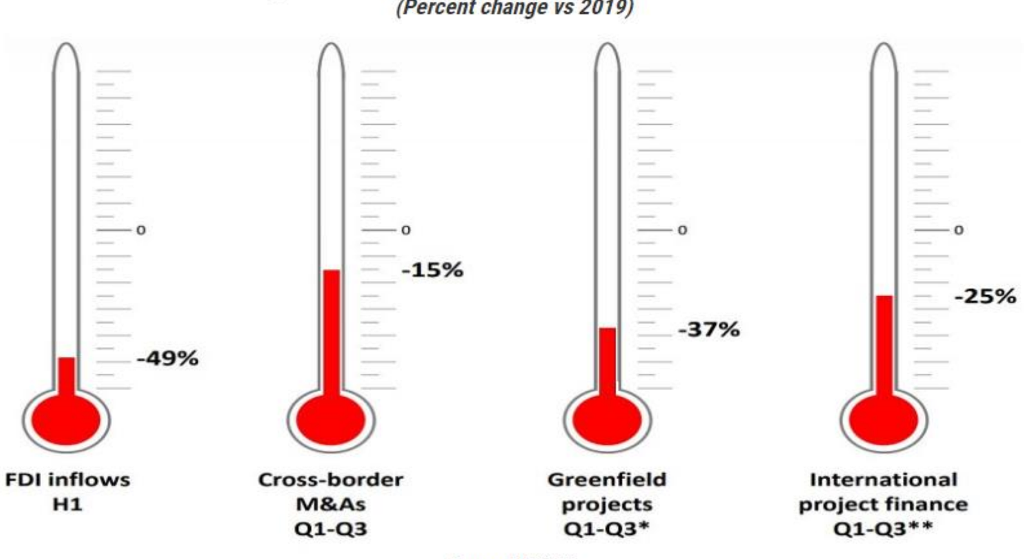
Notes

Figure 1 – FDI Inflows 2015–2019 (millions of dollars)



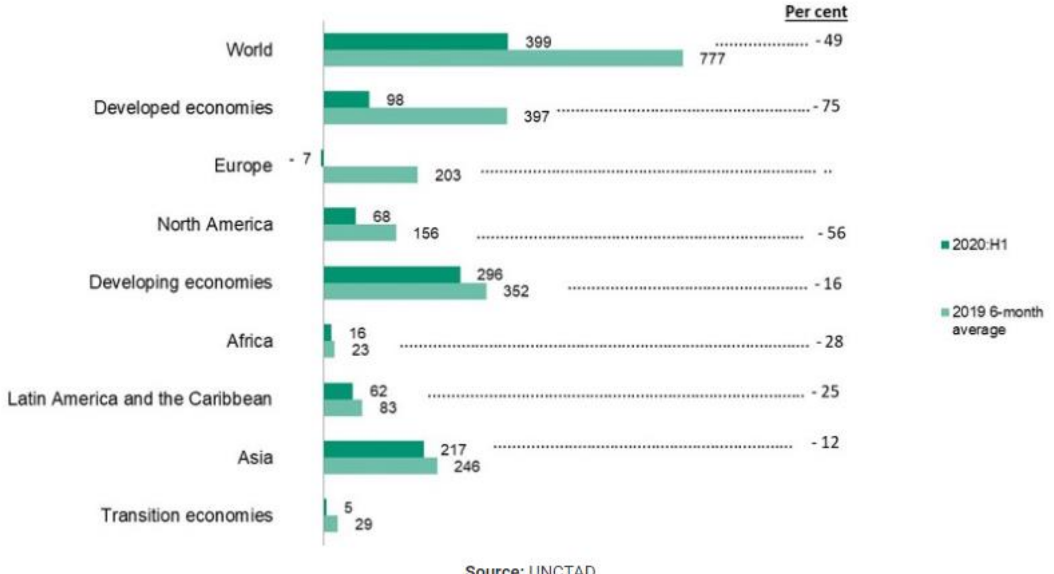
Global Status of FDI Trends- United Nation Conference on Trade & Development

Besides data, including personal data, is often now considered to be of potential strategic importance and several countries have introduced specific measures to address foreign investments in such areas. The new EU framework for the screening of FDI also specifically lists access to sensitive data, including personal data, as a relevant factor for member states to consider when reviewing investments on security or public order grounds. The new EU framework for the screening of FDI also specifically lists access to sensitive data, including personal data, as a relevant factor for member states to consider when reviewing investments on security or public order grounds.

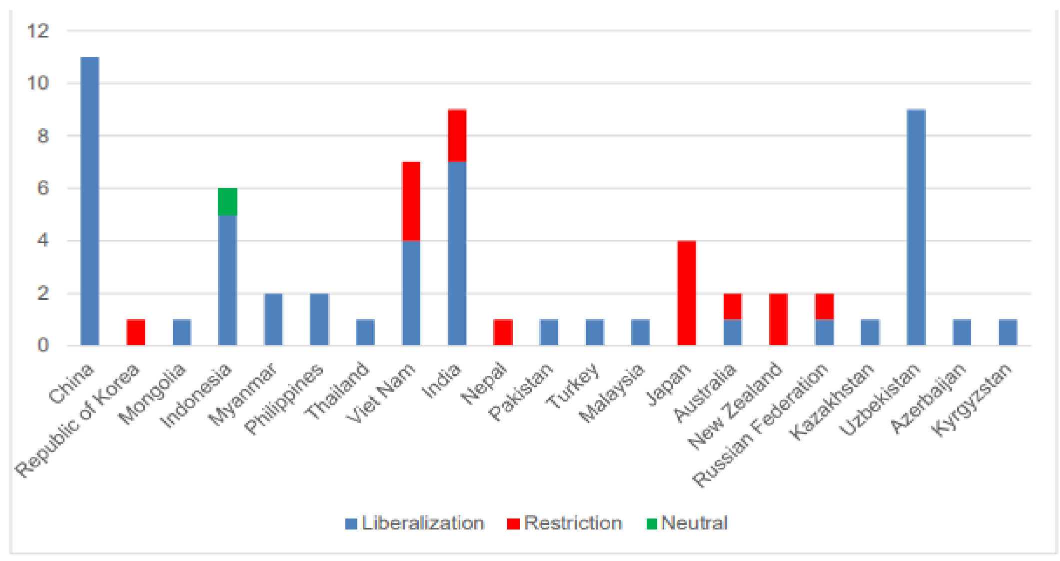


Global Investment trend 2020 Q1-Q3

Global foreign direct investment (FDI) flows fell 49% in the first half of 2020 compared to 2019, due to the economic fallout from COVID-19. In the wake of the pandemic, lockdowns around the world slowed existing investment projects and the prospects of a deep recession led multinational enterprises to reassess new projects. The FDI decline is more drastic than expected, particularly in developed economies. Developing economies weathered the storm relatively better for the first half of the year as can be seen from the charts.



FDI inflows by region, 2020 H1 vs 2019 (Billions of US dollars and percent)



Source: UNCTAD (2020) Investment Policy Hub. Geneva. Available at: https://investmentpolicy.unctad.org/ country-navigator.

Policy Priorities for Supporting FDI

Considering the future outlook related to FDI, It is difficult to predict beyond 2021. The recovery is dependent on the rate of recovery within the region and also on countries outside the region as far as covid-19 impact is concerned. Developing and implementing a green growth recovery strategy is the need of the hour with a robust role for both inward and outward FDI. The policymakers need to put in place policy measures to support both local and foreign SMEs in supply chains. The policymakers need to focus on boosting digital competitiveness.

While the extent and shape of the mid and long-term effects of the pandemic are likely to have lasting effects on investment policymaking. On one hand, it is expected to strengthen the ongoing trend towards a more protectionist approach that would restrict foreign investments in critical and sensitive industries. On the other hand, the economic crisis and its aftermath may trigger increased competition for attracting investment in other industries as economies seek to recover from the downturn.

As far as foreign investors are concerned, they find themselves in a situation of great uncertainty and are confronted with multiple and diversified sets of FDI screening rules in each jurisdiction.

This needs to be considered by the policymakers so that amicable policy support can be worked out.

3.3 Environmental factors influence on International Business

The environmental factors that influence the international business operations of the organizations include:

- Geographical locations
- Global climate change
- Environmental offsets

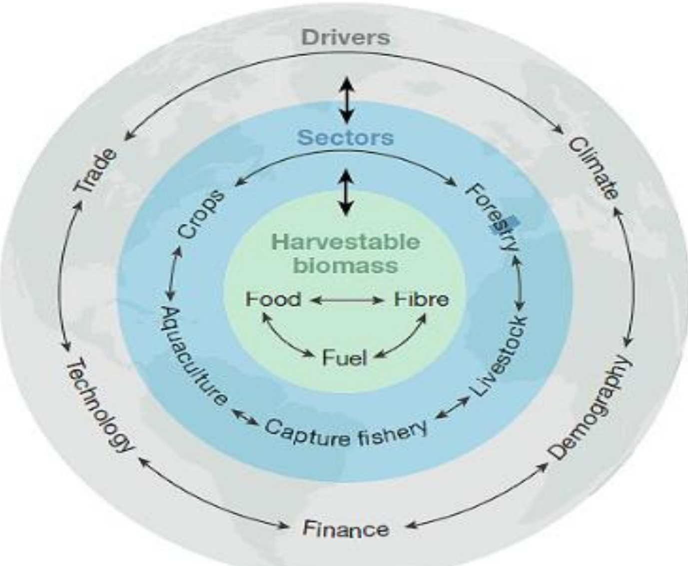
The operations of the international firms do get impacted when geographic locations changes due to expansion or diversification. Global climate change is a factor forcing companies to change the way they are operating. International firms are coming out with various measures to contribute positively to the environment. An environmental offset compensates for unavoidable impacts on significant environmental matters, (e.g. valuable species and ecosystems) on one site, by securing land at another site, and managing that land over some time, to replace those significant environmental matters which were lost.

Sustainability:

Sustainability involves having an understanding of the relationship between business, humanity, and nature. Clean air, drinkable water, food, a clean environment, and shelter are fundamental to human survival and business existence. Sustainability has evolved into a broad science integrating earth system (e.g., air, water, agriculture) disciplines with social sciences, including economics and sociology, to understand the complex cultural, environmental, and economic interrelationships that exist among humans, human organizations, and natural systems.

The Global Production Ecosystem

Farming, forestry, and fisheries are changing the anatomy of the biosphere. This makes us all more vulnerable to new types of global risks that will affect the long-term ability to provide food, fibers, and fuel to a growing and wealthier human population.



More than 75 percent of the world's land area has already been converted into domains like cities, farmland, and timber-producing forests. In the oceans, around 90 percent of fish stocks are either overexploited or fully exploited while a rapidly growing aquaculture sector is taking up more coastal and offshore space than ever.

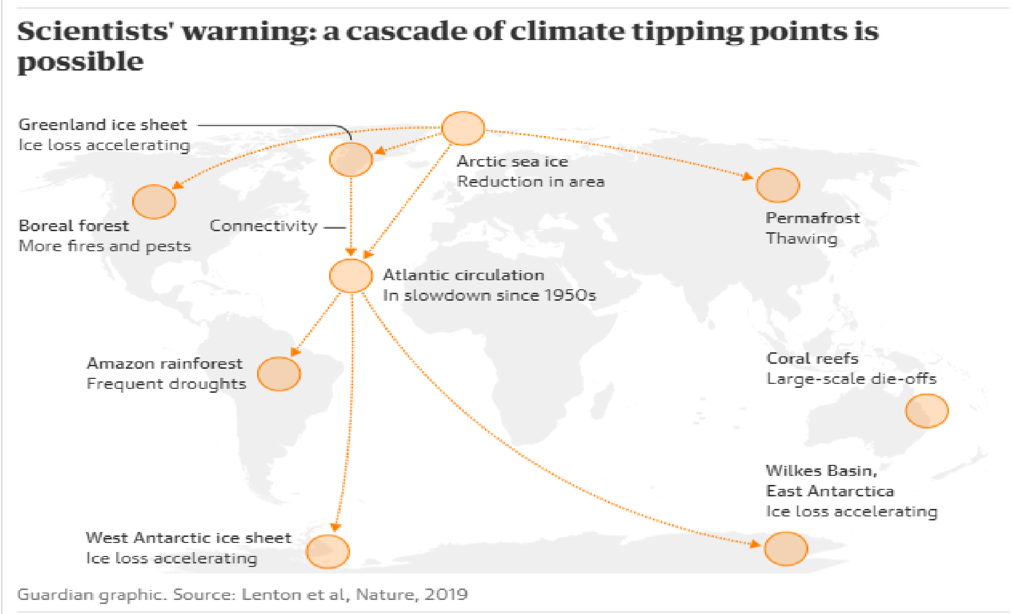
The Climate Change

There is a significant body of scientific research that indicates that global temperatures are rising and that rising global temperatures are directly linked to human activities involving the emissions

of greenhouse gases. The primary GHG of interest is carbon dioxide (CO2), which is a vital gas in our earth system and is released from various sources, including the combustion of fossil fuels.

The principal greenhouse gases that enter the atmosphere because of human activities also called anthropogenically are as follows:

- Carbon dioxide (CO2; 72 percent of anthropogenic emissions; GWP of one)
- Methane (CH4; 18 percent of anthropogenic emissions; GWP of twenty-five)
- Nitrous oxide (NxO; 9 percent of anthropogenic emissions; GWP of 298)
- Fluorinated gases (< 1 percent of anthropogenic emissions; HFC-23 has a GWP of 14,800)



Guardian graphic. Source: Lenton et al, Nature, 2019

Tipping points are reached when particular impacts of global heating become unstoppable, such as the runaway loss of ice sheets or forests. In the past, extreme heating of 5C was thought necessary to pass tipping points, but the latest evidence suggests this could happen between 1C and 2C.

The planet has already heated by 1C and the temperature is certain to rise further, due to past emissions and because greenhouse gas levels are still rising. The scientists further warn that one tipping point, such as the release of methane from thawing permafrost, may fuel others, leading to a cascade.

Since the 1980s each decade has been warmer than the previous one. And because of record levels of heat-trapping greenhouse gases in the atmosphere, the trend is expected to persist. In particular, carbon dioxide is driving the planet to future warming because it remains in the atmosphere for many decades. According to World Meteorological Organization Global Annual to Decadal Climate Update, there is a one-in-five chance that the average global temperature will temporarily exceed 1.5C by 2024. The situation is very alarming and it brings us to a point from where we have to look now how companies are responding to this external factor. Let us consider the efforts of the multinational enterprise in this direction with the help of an example.

Example: IKEA

One of the world's biggest furniture companies, IKEA generated 39.6 billion Euros in retail sales at 445 stores in more than 52 countries and online in 2019. It accounts for 0.1 percent of all global greenhouse gas emissions if you include everything from sourcing materials to customers' use of products in their own homes. IKEA's move comes at a time when big businesses are waking up to the idea of circularity. IKEA set out its goals which are in line with the UN Sustainable Development Goals for 2030.

A circular business eliminates waste and pollution while restoring natural systems. If the entire global economy could become circular, then human society could thrive without depleting the earth of its resources or destroying ecosystems. Whereas linear economy is a straight line, no matter

how efficient you make it. if you make a car with less material, if you make a car using less energy, you're still using the stuff. You're still consuming materials.

In 2020, 60 percent of IKEA's collections were made from renewable materials and 10 percent contained but were not solely made from recycled materials. Making the changes would require "big movements". IKEA has committed to reducing its carbon footprint, whilst growing the business and without purchasing carbon offset certificates. To achieve this, the company would need to reduce greenhouse gas emissions by at least 15 percent across the whole IKEA value chain, in absolute terms, by 2030. This was the equivalent of cutting the climate footprint of each product by 70 percent. As the materials that make up IKEA products were the company's largest source of CO2 emissions at 36.4 percent. For example, wood is the primary raw material in much of IKEA furniture, so it has been planting fast-growing, renewable poplar plantations in Slovakia since 2016 as a more sustainable source of timber. It is developing more sustainable glue, which is an essential component of the particle board in many IKEA products. To meet fire regulations, much of the company's wooden furniture must be coated with a fire retardant, which until now has been fossil-based. With an innovation partner, it has developed a biodegradable, cellulose-based alternative that is recyclable. IKEA would invest in innovative companies, solutions, and operations to facilitate the shift towards a net-zero carbon economy.

It has several renewable energy projects, including 546 wind turbines in 15 countries, two solar projects with 1.5 million solar panels, and over 920,000 solar panels on the roof of its IKEA stores and warehouses. These projects help Ingka Group (Parent company of IKEA) reach its objective to produce as much clean energy as the company consumes. This initiative falls into Ikea’s 2030 sustainability goals. In 2019, the company committed to becoming 100 percent circular by 2030. The plan is for all products to be designed with the potential to be reused, refurbished, or recycled, with an overall aim to reduce waste. Till 2020, IKEA has conducted a materials investigation, and some products already adhere to circular guidelines. A baby cot, for example, transforms into a toddler bed. But company leadership expected customers to start seeing marked improvements in stores over the next few years.

Now the question that arises over here is why would IKEA go through the effort of redesigning products and buying back furniture to find its niche in the circular economy?

A few of the benefits to this shift include saving on materials costs by reusing and recycling, creating jobs, finding new profit opportunities, and developing stronger relationships with customers about half of which are even willing to pay higher prices for environmentally friendly options. Therefore companies are eager in adopting sustainable business practices.

Let us consider another example to understand the same better.

Example: McDonald's

McDonald's restaurants are found in 120 countries and territories around the world and serve 68 million customers each day. McDonald's operates 37,855 restaurants worldwide, employing more than 210,000 people. The company has set a goal to source 100% of their guest packaging from renewable, recycled, or certified sources, and recycle guest packaging in 100% of McDonald’s restaurants by 2025. The company understands that recycling infrastructure varies from city to city and country to country.

McDonald’s most of the global packaging weight comes from fiber materials (78%), with the remaining 22% comprised of plastics. And while some plastic packaging is necessary to keep food fresh and safe, McDonald’s wants to be part of the solution and use their scale to accelerate a “circular economy”.

McDonald: Fiber lids replacing plastic lids

In France and some restaurants in Canada, the brand has introduced an innovative new fiber lid for cold drinks. The new fiber lids replacing the plastic lid are made from 100% certified sustainable sources and recyclable materials. The company has taken another initiative of replacing the plastic straws but that did not go so well for the company as the new straws cannot be recycled. McDonald's said the materials were recyclable, but their thickness made it difficult for them to be processed. Some customers were unhappy with the new straws, saying they dissolved before a drink could be finished, with milkshakes particularly hard to drink.

The restaurant chain uses 1.8 million straws a day in the UK, so the paper move was a significant step in helping to reduce single-use plastic. But eventually due to this issue company has stopped providing straws in its stores. The new initiative involves several innovative ideas, including removing plastic lids from McFlurry's across every European country in which McDonald's operates. This will save 1,200 tonnes of plastic per year. This reflects that companies across the globe are trying to adopt various initiatives to be environmentally friendly. This will give these firms a competitive advantage in the long run.

Self Assessment

1) Meeting the needs of the present without compromising the ability of future generations to meet their own needs is known as ________.

a. competitive advantage
b. the Kyoto Protocol
c. sustainability
d. externality

2) Firms that operate in countries that have adopted the Kyoto Protocol are required to either reduce emissions or ________.

a. purchase carbon credits from other firms
b. file petitions to appeal the requirement
c. cease manufacturing operations
d. pay fines to the UN

3) Which of the following best supports the idea that MNEs should remain in countries that allow child labor?

a. MNEs have a positive influence on government employment policies in most foreign countries.
b. Many MNEs have substantially improved the working conditions of their foreign plants.
c. MNEs are required to pay child workers more than local companies.
d. Most MNEs employ local managers to handle cultural differences.

4) ____________ is driving the planet to future warming because it remains in the atmosphere for many decades.

a) Carbon monoxide

b) Carbon dioxide
c) Ethanol
d) None of these

5) ______________ is one that eliminates waste and pollution while restoring natural systems.

a) Circular business
b) Rectangular business
c) Triangular business
d) None of these

6) The principal greenhouse gases that enter the atmosphere because of human activities are called ______________.

a) Philanthropic
b) Carbon monoxide
c) Methanol
d) Anthropogenic

7) Farming, ____________and fisheries are changing the anatomy of the biosphere.

a) Deforestation
b) Water
c) Forestry
d) None of these

8) Which of the following is not an environmental factor that influences international business operations of the organizations?

a) Demographics
b) Geographic locations
c) Global climate change
d) None of these

9) Which of the following is not risk while operating internationally?

a) Increasing competition
b) Damage to reputation
c) Political situation
d) None of these

10) Regulatory risk is beyond the control of the multinational enterprise.

11) Meeting the needs of the present without compromising the ability of future generations to meet their own needs is known as sustainability.

12) Legal and ethical values in a country may cause its companies to operate abroad according to home country laws rather than host country laws.

13) Consolidation in the telecom sector helped Vodafone India to perform better in the Indian market.

14) External environment factors are under organizational control.

15) In the long run, MNEs must adequately meet the needs of all stakeholders to prosper and survive.

Answer for Self Assessment

1.	C	2.	A	3.	B	4.	B	5.	A
6.	D	7.	C	8.	A	9.	D	10.	True
11.	True	12.	True	13.	False	14.	False	15.	True

Summary

Various risks need to manage by multinational enterprises while operating internationally. Like regulatory risks, damage to reputation, and inflationary risks.

FDI has grown substantially since the 1970s as governments have liberalized their markets and introduced measures to facilitate foreign investment.

The growth in foreign investment was especially marked from the mid-2000s onwards as countries sought to encourage cross-border investment, improve competitiveness, and foster growth.

Foreign investors find themselves in a situation of great uncertainty and are confronted with multiple and diversified sets of FDI screening rules in each jurisdiction.

The environmental factors that influence the international business operations of the organizations include geographical locations, global climate change, and environmental offsets.

Tipping points are reached when particular impacts of global heating become unstoppable, such as the runaway loss of ice sheets or forests.

There is a significant body of scientific research that indicates that global temperatures are rising and that rising global temperatures are directly linked to human activities involving the emissions of greenhouse gases.

Keywords

Regulatory Risk: Regulatory risk is the risk of a change in regulations and law that might affect an industry or a business. Such changes in regulations can make significant changes in the framework of an industry, and changes in the cost structure.

Anthropogenic: The principal greenhouse gases that enter the atmosphere because of human activities.

Tipping Points: Tipping points are reached when particular impacts of global heating become unstoppable, such as the runaway loss of ice sheets or forests.

Sustainability: It involves having an understanding of the relationship between business, humanity, and nature.

Circular Business: It eliminates waste and pollution while restoring natural systems.

Review Questions

1. How have sustainability demands affected international business operations?

2. Why do you think multinational companies have started adopting a circular business model in their operation?

3. What do you understand by the global production ecosystem?

4. Discuss in brief the environmental factors that impact the international business operations of the organizations.

5. What needs to be done by policymakers of economies in transition to support inflows of FDI in their countries?

6. Discuss in brief the various risks associated with international business operations.

Further Reading

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UNIT 4: International Trade Theories

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Learning Outcomes

Introduction

4.1 Trade Theories

Self-Assessment

4.2 Theories to Explain National Trade Patterns

Self-Assessment

4.3 The Diamond of National Competitive Advantage Theory

Self-Assessment

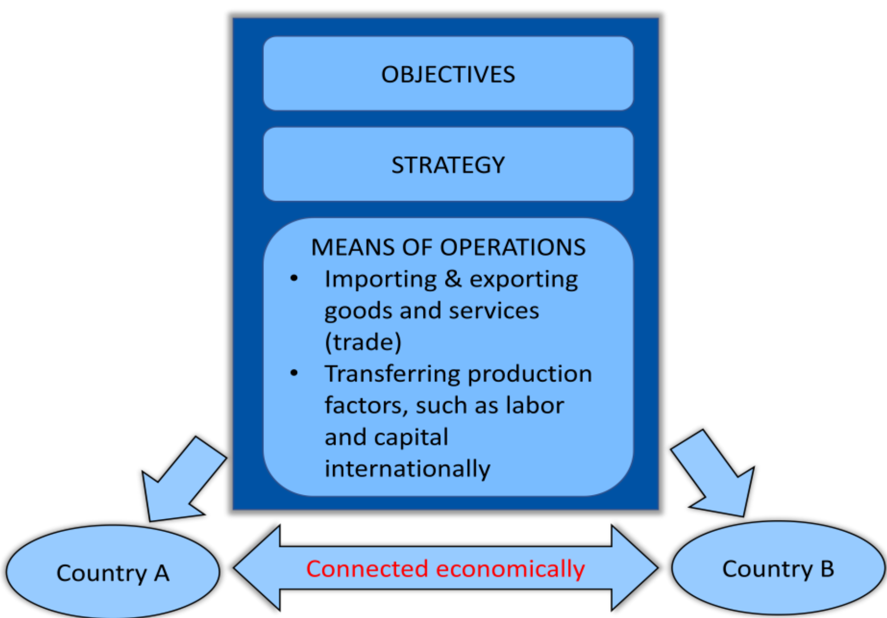
Learning Outcomes

After studying this unit, you should be able to

- comprehend theories that explain why they are beneficial for a country to engage in international trade.
- explain the absolute and comparative advantage theory
- interpret the diamond model of national competitive advantage theory.
- describe theories to explain national trade pattern

Introduction

To meet its international objectives, a company must gear its strategy to trading and transferring its means of operation across borders say, from home country A to host country B. Once either of these processes has taken place, the two countries are connected economically.



When we talk about means of operations it takes us to a very important question. Why do managers & policymakers rely on international trade theories? Why should the business firms of

one country go to another country, when the industries of that country also produce goods and market them? What is the basis for international business? Several theories have been developed to explain the basis of international business.

4.1 Trade Theories

Trade theory helps managers and government policymakers focus on these questions:

- What products should we import and export?
- How much should we trade?
- To whom should we trade?

Answers to these questions can be seen in various trade theories that will be discussed in the unit ahead.

Some trade theories prescribe that government should influence trade patterns. It includes theories like

- Mercantilism
- Neomercantilism

Mercantilism

Mercantilists maintained that the way a nation became rich and powerful was to export more than it imported. The resulting export surplus would then be settled by an inflow of bullion or precious metals, primarily gold and silver. Thus, the Government had to do all in its power to stimulate the nation's exports and discourage and restrict imports (particularly the import of luxury consumption of goods).

According to mercantilism, countries should export more than they import. It holds that a country's wealth is measured by its holdings of gold. This theory, which formed the foundation of economic thought from about the 1500 to 1800 century. To run a trade surplus, governments restricted imports and subsidized non-competitive production. Countries with colonies imported commodities from them that they would otherwise have to purchase from elsewhere. They monopolized colonial trade to force the colonies to export less highly valued raw materials to them and import more highly valued manufactured products from them. This way the colonies ran deficits that they paid off with gold.

The concept of balance of trade becomes important here as A favorable balance of trade also called a trade surplus still indicates that a country is exporting more than it imports. An unfavorable balance of trade also known as trade deficit indicates the opposite. Running a trade surplus is not necessarily beneficial, nor is running a trade deficit necessarily detrimental.

In the mercantilist period, the deficit was paid by a gold transfer.

Today, the surplus country, says China, grants credit to the deficit country, say the United States, by holding its currency US dollars or investments denominated in US dollars. If that credit cannot eventually buy sufficient goods and services, the so-called favorable trade balance actually may turn out to be disadvantageous for the country with the surplus.

Criticism

1. The theory viewed trade as a zero-sum game, again by one result in a loss by another. Adam Smith and David Ricardo showed the short-sightedness of the approach and demonstrated that trade is a positive-sum game or a situation where all the countries benefit.

2. Mercantilists measured the wealth of a nation by the stock of precious metals it possessed. In contrast, today we measure the wealth of a nation by its stock of human man-made, and natural resources, available for producing goods and services. The greater the stock of useful resources, the greater is the flow of goods and services to satisfy human wants and increase the standard of living of the nation.

Neomercantilism

A country that practices neomercantilism attempts to run an export surplus to achieve a social or political objective. This can be better explained well with the help of an example.

A country may reduce unemployment by encouraging its companies to produce more than the home demand and send the surplus abroad. Or it may attempt to maintain political influence in an area by sending more merchandise there than it receives, such as a government granting merchandise aid or loan to a foreign government.

We can see the example and Pakistan and China in this context. In December 2020 Pakistan used China's financial assistance to repay Saudi Arabia's loan. This time both the countries have agreed to increase the size of a 2011 bilateral Currency-Swap Agreement (CSA) by an additional 10 billion Chinese Yuan or around USD 1.5 billion. China has become Pakistan's largest creditor for the past few years. The trade facility, originally meant to promote bilateral trade in respective local currencies, has been used for paying foreign debt.

Some trade theories prescribe the approach of no governmental intervention. It includes theories like

- Free trade theories of absolute advantage
- Free trade theories of comparative advantage

Theory of Absolute Advantage

Absolute advantage holds that different countries produce different things more efficiently than others and that consumers should not have to buy domestically produced goods when they can buy them more cheaply from abroad. In other words, the advantage is when a producer can produce a good or service in greater quantity for the same cost, or the same quantity at a lower cost, than other producers. It can be either a natural advantage or an acquired advantage.

Natural advantage considers climate, natural resources, and labor force availability. Variations among countries in natural advantages also help explain where certain manufactured or processed items might best be produced, particularly if a company can reduce transportation costs by processing an agricultural commodity before exporting.

Taiwan's tea production

We can see a country like Taiwan whose major export used to be tea, a product it still exports and has advantages in producing because its high elevations give its tea a unique taste. Taiwan imports wheat. If it were to increase its wheat production, for which its climate and terrain less suited. It would have to use the land now devoted to tea as well as workers in some of its high-tech industries, thus reducing those earnings. Conversely, the United States produces a small quantity of tea. To become self-sufficient in tea production would require diverting resources away from the products such as wheat. For which its climate and terrain are naturally suited.

Here we can see trading tea for wheat achieves more efficiency than if these two countries were to try to become self-sufficient in the production of both. The more the two countries' natural advantages differ, the more they will favor trade with one another. This is what the theory of Absolute Advantage suggests, that different countries produce different things more efficiently than others and that consumers should not have to buy domestically produced goods when they can buy them more cheaply from abroad. It also reflects the example of natural advantage.

Acquired advantage occurs through either product or process technology. A product technology enables a country to produce a unique product or one that is easily distinguished from those of competitors.

Denmark exports silver tableware, not because there are rich Danish silver mines but because Danish companies have developed distinctive products

Adam Smith reasoned that unrestricted trade would lead a country to specialize in those products that gave it a competitive advantage. Its resources would shift to efficient industries because it

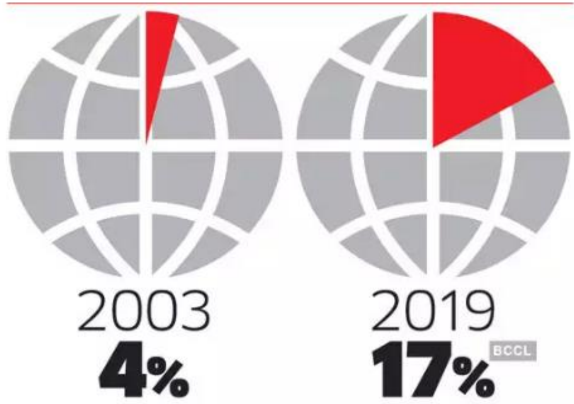
could not compete in the inefficient ones. Through specialization, it could increase its efficiency for three reasons:

- Labor could become more skilled by repeating the same tasks.
- Labor would not lose time in switching production from one kind of product to another.
- Larger amounts of production would provide incentives for developing more effective methods.

Let us understand the same with a small case-let on China.

Case-let on Chinese specialization in production

China makes inferior to good products across segments to cater to different price points and needs. So, from cheap plastic toys, festive lights, and wristwatch dials to computers, smartphones, and solar panels, Chinese companies play across segments. If we see the contribution of China to global GDP, it constitutes a very large part.



Chinese domination in tech products has been fuelled by its ability to commoditize at scale. China produces at scale and becomes the cheapest supplier of a particular commodity be it phone cases, batteries, electronic components, or solar panels. Nokia, for instance, used to be a dominant maker of mobile handsets. It used proprietary technology. Later with cheap chipsets from China and Taiwan, as well as customizable Android operating systems, the entire ecosystem became commoditized. The same process has been replicated in computers, washing machines, air conditioners, microwaves, and other products.

If we compare it with neighboring countries, we can see India's trade deficit with China is almost 56.8B dollars. This reflects the domination of China in world trade. The increasing shipment of goods from China to India during the past few years shows India's demand for products made in China, which is a result of the different economic and industrial structures of the two economies and the underlying reason for India's trade deficit with China.

Over the past few decades, India and China have seen their bilateral trade surge due to mutual complementarities, but an expanding trade deficit with China has been bothering New Delhi. However, simply narrowing its trade deficit with China in terms of statistics is not the best approach. Only by effectively upgrading its industrial structure can India improve its trade pattern with other countries, and this is not a short-term project for any country. China too has taken time in establishing a manufacturing hub that is now helping the country export in all parts of the globe. This reflects the importance of acquired advantage in absolute advantage theory.

Pitfalls

1. The theory is vague and lacks clarity.

2. According to this theory, every country should be able to produce certain products at a low cost compared to other countries and should produce certain other products at comparatively high costs than other countries. International trade takes place only under such conditions. But in reality, most of the developing countries do not have the absolute advantage of producing at the lowest cost any

commodity, yet they participate in international business. Thus, Smith's analysis is weak and unrealistic.

Theory of Comparative Advantage

It suggests that global efficiency gains may still result from trade if a country specializes in what it can produce most efficiently regardless of other countries' absolute advantage.

Imagine that the best physician in town also happens to be the best medical administrator.

It would not make economic sense for the physician to handle all the office's administrative duties because the physician can earn more money by concentrating on medical duties, even though that means having to hire a less-skilled office administrator. Comparative advantage takes into account the opportunity cost of specializing in one activity over another. It might be cheaper for India to operate call centers compared to the Philippines, but the potential gains from other activities, such as information technology services, might be far greater.

David Ricardo illustrated the Comparative Cost Theory in 1817. He used two countries, two-commodity model. The conclusions of his model are:

1. Trade between two countries is profitable when a country produces one good at a lower cost than another country and that another country produces another good at a lower cost than the former country.

2. Trade between two countries is also profitable when one country produces more than one product efficiently, but when it produces one of these products comparatively at greater efficiency than the other product.

3. Both nations can engage in international trade when one country specializes in production in which it has greater efficiency than the other.

Self-Assessment

Multiple-choice questions

1. If the cost of production of items X and Y in China and Russia are as given below, which statement will be more appropriate?

	China	**Russia**
X	**14**	**19**
Y	**11**	**22**

a) Russia will import X and Y from China

b) Russia will export X to China and import Y from China

c) China will import Y from Russia and export X to Russia

d) Russia will import X from China

2. The trade theory that says a country should export more than it imports is known as ________.

a) mercantilism

b) absolute advantage

c) comparative advantage

d) import substitution

3. Under mercantilism, governments sought to influence trade by ________.

a) establishing bilateral trading agreements with other countries

b) limiting exports

c) limiting imports and subsidizing exports

d) encouraging the development of manufacturing in their colonies

4. Which of the following undesirable results will most likely occur for a country running a favorable balance of trade?

a) higher unemployment

b) higher domestic interest rates

c) fewer funds to invest abroad

d) granting credit that may be risky

True/False

5. Understanding trade theories helps companies know if they will need to compete against goods and services produced abroad.
True
False

6. Countries enact trade policies based on trade theories, which, in turn, affect companies' optimum production locations.

True

False

Answer

1) B 2) A 3) C 4) D 5) True 6) True

4.2 Theories to Explain National Trade Patterns

The free trade theories demonstrate how output growth occurs through specialization and free trade; however, they do not deal with trade patterns such as:

- How much a country trade? - Theory of country size
- What products does it trade? – Factor Proportions Theory
- Who will be its trading partners? – Country-Similarity Theory

Theory of Country Size

The theory of country size holds that countries with larger landmasses usually depend less on trade than smaller ones. They are apt to have more varied climates and an assortment of natural resources that make them self-sufficient. Most large countries (Such as Brazil, China, India the United States, and Russia) import less of their consumption and export less of their production output than do small nations (Such as Uruguay, Belgium, and Sri Lanka). Furthermore, distance to foreign markets affects large and small countries differently.

For example: assume that the normal maximum distance for transporting a product is 100 miles because costs rise too much at greater distances.

Although almost any location in Belgium is within 100 miles of a foreign country, the same is not true for its two largest neighbors France and Germany. This shorter distance to foreign markets for Belgium additionally helps to explain its higher dependence on trade as a percentage of its production and consumption. So, this question gets answered with this as how much a country trade. The size of the economy also matters as larger economies are the biggest traders because they produce and consume more. While land area helps explain the relative dependence on trade, countries' economic size helps explain absolute differences in the amount of trade. Let us see the same by looking at some largest economies of the world.

Trillion-Dollar Economies		
Country	GDP (2019 Estimates, In trillions)	Projected Growth Rate (2020)
United States	$21.44	2.0%
China	$14.14	6.0%
Japan	$5.15	0.7%
Germany	$3.86	1.1%
India	$2.94	5.8%
United Kingdom	$2.74	1.4%
France	$2.71	1.3%
Italy	$1.99	0.5%
Brazil	$1.85	2.2%
Canada	$1.73	1.8%
Russia	$1.64	1.9%
South Korea	$1.63	2.2%
Spain	$1.40	1.6%
Australia	$1.38	2.3%
Mexico	$1.27	1.0%
Indonesia	$1.11	5.1%

Trillion Dollars Economies of the World

The United States offers a good example of the difference between relative and absolute dependence on trade because it is the third-largest country in the area and the largest economically. Although its dependence on either imports or exports is comparatively low as a percentage of either production or consumption.

What does United States trade with foreign countries?

The above statistics reflect that America imports more than it exports and major sectors comprised of capital goods, consumer goods, industrial goods, automotive, and foods. This analysis of data takes us to the Factor proportions theory which answers what products it trades?

Factor Proportions Theory

According to factor proportions theory, countries have their best trade advantage when depending on their relatively abundant production factors. In other words, Differences in a country's relative endowments of land, labor, and capital explain differences in the cost of production factors.

Factor Proportions theory of international trade explains that in a two-country, two-factor, and two-commodity framework different countries are endowed with varying proportions of different factors of production. Some countries have large populations and large labor resources. Thus, a country with a large labor force will be able to produce the goods at a lower cost using a labor-intensive mode of production.

Similarly, countries with a large supply of capital will specialize in goods that involve a capital-intensive mode of production. The former will export its labor-intensive goods to the latter and import capital-intensive goods from the latter. After the trade, both the countries will have two types of goods at the least cost.

Densely populated Hong Kong uses little land for agriculture and produces manufactured products not requiring large amounts of land.

Canada is the opposite. Hong Kong does best in manufacturing operations that use a minimum of land per worker like printing, clothing, and watches. By locating these in multi-story buildings. Canada produces agricultural and manufactured products that require lots of land per workers, such as wheat and automobiles. This reflects the importance of factors that are in abundance on which economies rely similarly, on the one hand, Germany, a country with a vast amount of capital relative to its population excels at chemical production, which requires capital intensity. On the other hand, Bangladesh, a country with abundant labor relative to capital, excels at apparel production, which is labor-intensive. So, this is how to factor proportion theory is being applied by various economies and companies depending upon the availability of these factors.

Various Aspects of Factor Proportion Theory

- Production factors, such as land and labor, are not homogeneous.
- Companies may substitute capital for labor, depending on the cost of each.
- Countries with bigger markets depend more on producing products requiring larger production runs.
- Most new products originate in developed countries.

As the factor proportions theory assumes production factors to be homogeneous, neither land nor labor is homogeneous. The land varies, for example, in its arability and productivity similarly labor varies by skill level because of training and education differences that require capital expenditures.

Example:

Rice harvesting in Indonesia, where many manual labours

Italy use mechanized methods with few labours

The photos show rice harvesting in Indonesia where many manual laborers are employed, versus Italy, where mechanized methods require few workers. The optimum location of production depends on comparing the cost in each locale based on the type of production that minimizes the cost there. Some require huge amounts of fixed capital and long production runs to spread the fixed capital costs over more output units. These usually are located in countries with large markets. However, companies may locate long production runs in small countries if they can export from them.

Manufacturing competitiveness depends largely on technology to develop new products and processes, which, in turn, depends on a large number of highly educated people and a large amount of capital to invest in R&D. Because developed countries have an abundance of these features, they originate most new products and Account for most manufacturing output and trade.

Now coming onto the third Question that highlights with whom do countries trade? That takes us to Country-similarity theory

Country-Similarity Theory

According to this theory, when a firm develops a new product in response to observed conditions in its home market, it is likely to turn to those foreign markets that are most similar to its domestic market when commencing its initial international expansion activities.

This tendency is reflective of:

- the cultural similarity of nations
- the similarity of national political/economic interests
- the economic similarity of industrialized countries

Developed countries trade primarily with each other because they produce and consume more, and emphasize technical breakthroughs in different industrial sectors. Product differentiation causes countries to conduct two-way trade in seemingly similar products.

Staffan B. Linder divided international trade into two different categories: primary products and manufactured goods. Linder asserts that differences in factor endowments explain trade in natural resource-intensive products but not in manufactured goods. He argues that the range of a country's manufactured exports is determined by internal demands. International trade in manufactured goods takes place largely among developed nations because nations will only export those goods they manufacture at home and will manufacture at home only those goods for which there is a strong domestic demand.

Factor Mobility Theory

Factor mobility concerns the free movement of factors of production, such as labor and capital, across national borders. While capital is the most internationally mobile factor, short-term capital is the most mobile of all. Capital is primarily transferred because of differences in expected returns, but firms may also respond to government incentives.

People transfer internationally to work abroad, either temporarily or permanently. Motives are:

- economic motives
- political motives

Brain drain occurs when educated citizens leave a country, but a nation may in turn gain from the remittances that citizens who are working abroad send home.

Nearly 80,000 Indians with H-1B visas work for Tata Consultancy Services, Infosys, and other Indian information technologies companies.

The Relationship Between Trade & Factor Mobility

Factor mobility through foreign investment often stimulates trade because of

- The need for components,

- The parent company's ability to sell complementary products,
- The need for equipment for subsidiaries

Self-Assessment

Multiple-choice questions

7. Factor mobility refers to the movement of which of the following combinations?
   a) capital, technology, and people
   b) currency, profits, and raw materials
   c) labor, capital, and management
   d) trade, profits, and materials

8. The free-trade theories of specialization primarily assume that ________.
   a) specialization leads to unemployment, but production gains compensate for job losses
   b) resources can move internationally from the production of one good to another
   c) resources can move domestically from the production of one good to another
   d) countries have objectives other than economic efficiency

9. Countries with varied climates and varied natural resources generally ________ than countries with less varied climates and natural resources.
   a) have lower per capita incomes
   b) depend less heavily on trade
   c) have more ethnic subgroups
   d) have higher endowments of capital relative to labor

10. The trade theory that says countries should concentrate production on those products using their most abundant production factors is the ________.
    a. factor proportions theory
    b. theory of comparative advantage
    c. theory of absolute advantage
    d. none of these

11. All countries face the questions of what, how much, and with whom they should import and export. How they answer these questions primarily affects whether ________.
    a. non-tradable goods become tradable
    b. products go through a long life cycle
    c. companies adhere to laissez-faire export policies
    d. a company's present production location will be competitive

Answer

7) A 8) C 9) B 10) A 11) D

4.3 The Diamond of National Competitive Advantage Theory

Before we understand the diamond model it is necessary to answer few fundamental questions that are required to be addressed.

- Why are certain companies based in certain nations capable of consistent innovation?
- Why do they ruthlessly pursue improvements, seeking an ever more sophisticated source of competitive advantage?
- Why are they able to overcome the substantial barriers to change and innovation that so often accompany success?

The answer lies in four broad attributes of a nation, attributes that individually and as a system constitute the diamond of national advantage, the playing field that each nation establishes and operates for its industries. These attributes are:

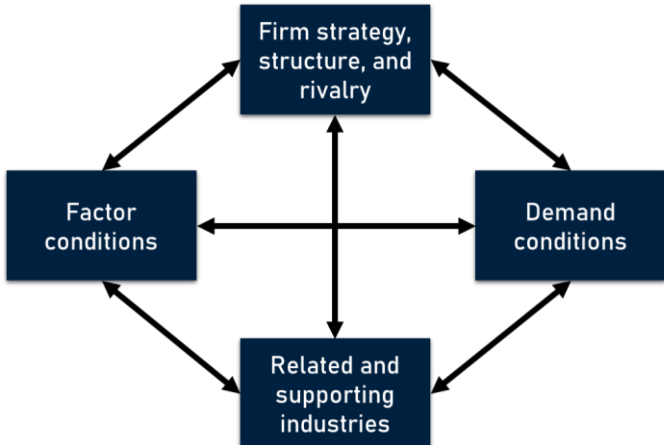
1. Factor Conditions. The nation's position in factors of production, such as skilled labor or infrastructure, necessary to compete in a given industry.

2. Demand Conditions. The nature of home-market demand for the industry's product or service.

3. Related and Supporting Industries. The presence or absence in the nation of supplier industries and other related industries that are internationally competitive.

4. Firm Strategy, Structure, and Rivalry. The conditions in the nation governing how companies are created, organized, and managed, as well as the nature of the domestic rivalry.

These determinants create the national environment in which companies are born and learn how to compete.



Determinants of National Competitive Advantage (Porter’s Diamond Model)

According to the diamond of national competitive advantage theory, companies’ development and maintenance of internationally competitive products depend on favorable:

- Demand conditions,
- Factor conditions,
- Related and supporting industries,
- Firm strategy, structure, and rivalry.

We have discussed these conditions in the context of other trade theories, but how they combine affects the development and continued existence of competitive advantages. The framework of the theory, therefore, is a useful tool for understanding how and where globally competitive companies develop and sustain themselves. Let us understand the same with the help of a case.

The case of the Italian Ceramic Tile Industry

In 1987, Italian companies were world leaders in the production and export of ceramic tiles, a $10 billion industry.

The concentration of industries was in and around the small town of **Sassuolo**, which accounted for about 30% of world production and almost 60% of world exports. The geographic location of Italy can be seen through the map below.

The competitive advantage was developed not from any static or historical advantage but dynamism and change. Sophisticated and demanding local buyers, strong and unique distribution channels and Intense rivalry among local companies created constant pressure for innovation. Continuous experimentation and cumulative production lead to loyalty to community & Private ownership.

Tile producers benefited as well from a highly developed set of local machinery suppliers and other supporting industries, producing materials, services, and infrastructure. The geographic concentration of the entire cluster supercharged the entire process. The organic nature of this system represents the most sustainable advantage of Sassuolo's Ceramic tile companies. Tile production originated in Sassuolo grew out of the earthenware and crockery industry (13th century). Pre-World War-II very few local manufacturers serving the need of locals. Post wars years demand increased. In 1955 there were only 14 companies that were producing ceramic tiles and by 1962 number of companies increased to 102.

The new Co's benefited from a local pool of mechanically trained workers (Ferrari, Maserati, Lamborghini). But the industry was dependent upon the foreign source of raw material & production technology. In the 1950s, the principal raw materials used to make tiles were kaolin (White) clay and Italy had red clay deposits so had to import from the UK. Tile-making equipment was imported from Germany(Kilns), America(Presses) & France along with glazing machines.

Producers learned how to modify imported equipment to fit local circumstances (Red Vs. White Clay, Natural Gas Vs. Oil).

Technicians from tile companies left to start their own equipment companies, a local machinery arose in Sassuolo. By the 1970s they starting exporting the equipment. By the 1980s there were 200 Italian equipment manufacturers (60% in Sassuolo). The equipment manufacturers competed fiercely for local business, and tile manufacturers benefited from better prices and more advanced equipment than their foreign rivals.

As the emerging tile cluster grew and concentrated in the Sassuolo region, a pool of skilled workers and technicians developed, including engineers, production specialists, maintenance workers, service technicians, and design personnel. The industry's geographic concentration encouraged other supporting companies to form, offering molds, packaging materials, glazes, and transportation services.

An array of small, specialized consulting companies emerged to advise on plant design, logistics, and commercial advertising, and fiscal matters. By the mid-1960s, per-capita tile consumption in Italy was considerably higher than in the rest of the world. Italian customers, who were generally the first to adopt new designs and features, and Italian producers, who constantly innovated to improve manufacturing methods and create new designs, progressed in a mutually reinforcing process.

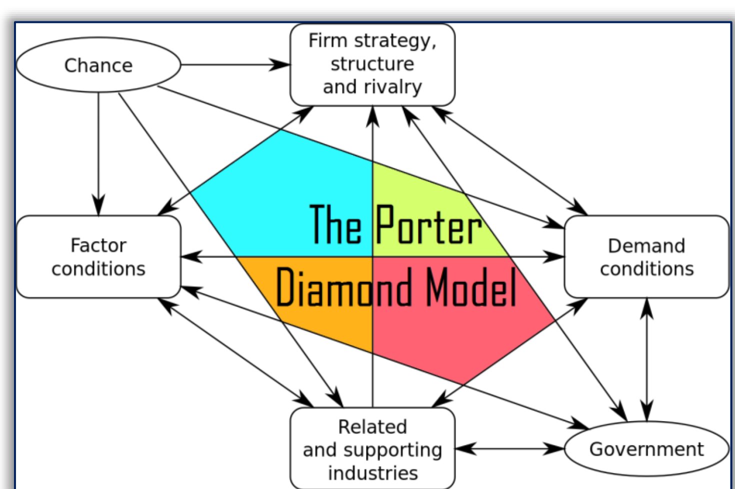
Domestic demand slowly extended to retail outlets. In the 1960s, specialized tile showrooms began opening in Italy. 1985 roughly 7,600 specialized showrooms were handling approximately 80% of domestic sales. In 1976, the Italian company Piemme introduced tiles by famous designers to gain build brand name awareness among consumers. This innovation drew on another related industry, design services, in which Italy was the world leader, with over $10 billion in exports.

Sheer no. of companies Sassuolo area created an intense rivalry. The Proximity added a personal note to the rivalry as almost all manufacturers knew each other. The early 1970s faced intense domestic rivalry due to pressure from retail customers and the shock of the 1973 energy crisis-struggled to reduce gas & labor costs. It resulted in a technological breakthrough.

Single firing process (hardening process, material transformation & Glaze) which needed earlier 225 employees and 16 hours reduced to 90 employees and only 50 minutes. The new smaller and lighter equipment was also easier to export (1980 export exceeded domestic sales;1988 exports were 80% of total sales). In the late 1970s, the ceramic industry moved from batch to continuous process to reduce labor costs.

In the 1970s, Italian domestic demand matured and started pursuing foreign markets. The presence of related & supporting Italian industries helped in export drive, and huge promotion started. Capitalized on Italy’s leading export position in related industries like marble, sinks, washbasins, etc. it helped in establishing trade promotion offices (US, Germany, France).

To conclude, it becomes clear that Porter’s determinants give us good explanations for the factor and demand conditions that are key to the foundations of organizational strategies, structures, and clusters within an economy.



Conversely, the diamond model applies mostly to the home economy, which is geared around exporting from its national organizations and clusters. It is not always proving relevant to economies, which have a more international element, namely multinational enterprise and inward foreign investment.

The Tile Industry case discussed above and does not cover all the aspects of how it achieved economic success, only how an industry contributed towards the level of its competitive advantage.

Self-Assessment

Multiple-choice questions

12. The diamond of national advantage would be best used to answer which of the following questions?

   a. How do developed countries prevent the trade of blood diamonds?
   b. How can developing countries create a significant trade surplus?
   c. Why do specialized competitive advantages differ among countries?
   d. Why do most innovative products originate in developed countries?

13. All of the following are features of the diamond of national advantage theory EXCEPT ________.

   a. firm strategy, structure, and rivalry
   b. strategic trade policy regulations
   c. related and supporting industries
   d. demand conditions

14. According to the diamond of national advantage theory, the domestic existence of all four conditions best explains ________.

   a. the essence of an industry's development
   b. the position of a product in its life cycle
   c. where globally competitive firms develop and sustain themselves
   d. why countries rely on abundant factor endowments

True/False

15. The existence of the four favorable conditions of the diamond of national advantage does not guarantee that industry will develop in a given locale.

True

False

Answer

12) C 13) B 14) C 15) True

Summary

This unit attempts to provide information on various trade theories in simple ways

Mercantilists maintained that the way a nation became rich and powerful was to export more than it imported. The resulting export surplus would then be settled by an inflow of bullion or precious metals, primarily gold and silver.

A country that practices neomercantilism attempts to run an export surplus to achieve a social or political objective.

Absolute advantage holds that different countries produce different things more efficiently than others and that consumers should not have to buy domestically produced goods when they can buy them more cheaply from abroad.

The theory of comparative advantage suggests that global efficiency gains may still result from trade if a country specializes in what it can produce most efficiently regardless of other countries' absolute advantage.

The theory of country size holds that countries with larger landmasses usually depend less on trade than smaller ones. They are apt to have more varied climates and an assortment of natural resources that make them self-sufficient.

According to factor proportions theory, countries have their best trade advantage when depending on their relatively abundant production factors.

Factor mobility concerns the free movement of factors of production, such as labor and capital, across national borders.

According to the diamond of national competitive advantage theory, companies’ development and maintenance of internationally competitive products depend on favorable: demand conditions, factor conditions, related and supporting industries, firm strategy, structure, and rivalry.

Keywords

Mercantilists: maintained that the way a nation became rich and powerful was to export more than it imported. The resulting export surplus would then be settled by an inflow of bullion or precious metals, primarily gold and silver.

Absolute advantage: holds that different countries produce different things more efficiently than others and that consumers should not have to buy domestically produced goods when they can buy them more cheaply from abroad.

The theory of comparative advantage: suggests that global efficiency gains may still result from trade if a country specializes in what it can produce most efficiently regardless of other countries’ absolute advantage.

The theory of country size: holds that countries with larger landmasses usually depend less on trade than smaller ones. They are apt to have more varied climates and an assortment of natural resources that make them self-sufficient.

Factor proportions theory: states that countries have their best trade advantage when depending on their relatively abundant production factors.

Factor mobility: concerns the free movement of factors of production, such as labour and capital, across national borders.

Review Questions

1. What is the theory of country size? How is the country size determined? How does country size affect national trade patterns?

2. What is the country similarity theory? According to this theory, what factors affect trade patterns?

3. In a short essay, discuss the theory of mercantilism, and discuss favorable and unfavorable balances of trade as they apply to international business.

4. In a short essay, discuss the theory of absolute advantage and the reasons a country's efficiency improves based on this theory.

5. What is the difference between the free-trade theories of absolute advantage and comparative advantage?

6. From an economic standpoint, why do production factors move from one country to another? How does factor movement affect international trade?

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UNIT 5: Protectionism and Trading Environment

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5.2 Protectionism

Self-Assessment

5.3 Tariff and Non-tariff Barriers

Self-Assessment

Learning Outcomes

After studying this unit, you should be able to

- outline various challenges faced by foreign trade and investment.
- interpret the conflicting outcomes of trade protectionism.
- understand the major instruments of trade control.
- Select the major instruments of trade control.

Introduction

The term protectionism, when applied to international trade, refers to governmental restrictions and incentives to affect trade flows. One of the keys to business success is the ability to trade internationally and participants regularly try to draw ways of how to tackle the challenge of remaining competitive while growing the business by going global. Expanding internationally can be an attractive and lucrative business proposition, and international business, across both developed and emerging markets, offers a wealth of new opportunities. It is important to recognize that organizations need to improve their game to engage effectively with their clients, who themselves are established in global businesses. This can be achieved if the firms can manage various challenges in the right manner.

5.1 Challenges faced by firms while operating internationally

A few of the important challenges that are faced by firms while operating internationally are:

- Language Barriers
- Cultural Differences
- Managing Global Teams
- Currency Exchange & Inflation Rates
- Foreign Politics, Policy, and Relations

Let us try and understand the impact of these on the overall operations of the organizations that are operating internationally. The lack of sufficient competence in a language can lead to misunderstandings which in turn leads to big losses in money. Corporations lose their potential clients and actual businesses because of their lack of sufficient knowledge in different languages. If companies can catch hold of it nicely then this brings better prospects for the company to flourish. Let us take an example to understand the impact of language barriers.

Example: Google

It's no secret that India is one of the most linguistically diverse nations in the world. With 22 official languages and a hundred more that aren't, it can be quite challenging for a company to break the language barrier. But Google has been making efforts to localize its products and services for a billion Indians. For starters, Maps in India are now available in nine local languages, including Gujarati, Marathi, and Tamil. Similarly, Google is making it easier to switch results to Indian languages, five to be precise within Search.

There are more than 600 million internet users in India in 2020, but only a fraction of this population is fluent in English. Most online services and much of the content on the web currently, however, is available exclusively in English. This language barrier continues to contribute to a digital divide in the world's second-largest internet market that has limited hundreds of millions of users' rendition of the world wide web to a select few websites and services. So, it comes as no surprise that American tech giants, which are counting on emerging markets such as India to continue their growth, are increasingly attempting to make the web and their services accessible to more people. The company, which counts India as its biggest market by users, committed to investing more than $10 billion in the country over the coming years. This reflects that until and unless the organization is not going to pay attention to the native language of the country in which it's operating, the language barrier can pose a challenge to the organizations.

Let us take another famous example of Mercedes Benz's entry into China.

Example: Mercedes Benz entry into the Chinese market

China has a population of over 1.4 billion, and only about 10 million people speak English. That is less than 1% of the population. How do a company plan to conquering the huge market of China when the majority of the general public cannot read or pronounce the brand name, furthermore companies want the consumer to remember them? Having a Chinese name certainly helps the general public in remembering a new and foreign brand.

Secondly, brand translation is more than directly translate the original name, it's called localization: taking not only the language but also the cultural background of the target market into consideration. Names are very important in China, a brand name reflects not only the brand itself, but also who are the targeting market, the image of the business, and even the class or level you want to target. The earliest Chinese translation for Mercedes-Benz was '*Bensi*', which may sound pretty good until you hear it means 'rush to die' in Chinese.

The translation of brand Mercedes-Benz in Traditional Chinese and Mandarin Chinese

In traditional language, it is called a Gentleman or Scholar. And just like this name suggests, the brand is a gentleman's car. This name direct translate as 奔 Bēn: Fast running, and 驰 chí: Speed in Mandarin As you can see this Chinese name emphasize the performance of the vehicle, targeting consumers seeking for speed in luxury. This helped Mercedes to get better recognition in the market.

Nickname of brands without a Chinese name given by general public in China

The general public is given the above 2 mentioned brands a nickname based on the image of the logo. The nickname helps Chinese consumers to remember the brand. However, when the brand decides to choose a Chinese name, the consumer already knows the brand as the nickname that they gave, and it's very hard to change the general public's view.

The cultural difference between the United States and Spain is the hours of a typical workday. In the United States, working hours are 9 a.m. to 5 p.m., often extending earlier or later. In Spain, however, working hours are typically 9 a.m. to 1:30 p.m. and 4:30 to 8 p.m. The break in the middle of the workday allows for a siesta, which is a rest taken after lunch in many Mediterranean and European countries.

Another challenge of international business is managing employees who live all over the world. When trying to function as a team, it can be difficult to account for language barriers, cultural differences, time zones, and varying levels of technology access and reliance.

Managing global teams can be seen with the help of the example of Google.

Google knows this better than anyone else: 2 in 5 of its teams include Googlers in more than one location; 30% of its meetings involve two or more time zones.

Remote working doesn't come without friction. Google uncovered that working with colleagues across the globe makes it more challenging to establish relationships. Google's using video over plain voice conferences. Though this seems obvious, most organizations still rely heavily on audio calls.

It's also important to monitor inflation rates, which are the rates that general price levels in an economy increase year over year, expressed as a percentage. Inflation rates vary across countries and can impact materials and labor costs, as well as product pricing. Business doesn't exist in a vacuum it's influenced by politics, policies, laws, and relationships between countries. Because those relationships can be extremely nuanced, it's important that companies closely follow news related to countries where they do business.

As we can see in the case of an economy like India, where data suggest likely contraction of the Indian economy in FY21 may have an even deeper impact on business with China as the government pushes for Self-Reliant India. China's role in the spread of coronavirus across the world and the economic distress to the global economy has caused a backlash among business communities and consumers across India. The trade deficit with mainland China now under $50 billion marks for the first time in 5 years. Mainland China was India's largest trade partner until the US overtook in FY19. All the above-mentioned examples reflect the external challenges faced by international firms.

Self-Assessment

Multiple Choice Questions

1. Which of the following is not going to act as a challenge for firms operating internationally?

a) Culture difference
b) Language barriers
c) Promotors
d) Foreign politics

2. What was the initial translation of Mercedes Benz in Chinese when they entered China?

a) Ben Chi
b) Bensi
c) MeiShi
d) Benzi

3. X is looking to enter a country where currency fluctuation is very high in comparison to other countries. Which of the following statement will work for an export-oriented organization X that deals in consumer durables products?

a) X should avoid entering such a nation
b) X should enter without worrying much as fluctuation can be profitable for the organization.
c) X should evaluate the buyers operating in that market before entering
d) X should analyze the current fluctuation and its impact on its margin before entering

Answer

1) C 2) B 3) D

5.2 Protectionism

Protectionism refers to government policies that restrict international trade to help domestic industries. Protectionist policies are usually implemented to improve economic activity within a domestic economy but can also be implemented for safety or quality concerns. Despite free trade benefits, governments intervene in trade to attain economic, social, or political objectives. Officials enact trade policies that they reason will have the best chance to benefit their nation and its citizens and, in some cases, their political longevity. Their decisions are complicated because outcomes are uncertain and affect groups of their citizens differently.

In response to a variety of institutional factors (cultural, political/legal, and economic), governments enact measures designed to either enhance or restrict international trade flows. These measures invariably affect the competitive environment in which companies operate internationally. To an extent, of course, the converse is also true: companies influence government trade policies that affect their institutions. Governments intervene in international trade for either economic or noneconomic reasons, let's begin by analyzing some leading economic rationales.

Economic Rationales for Governmental Trade Intervention

- Fighting unemployment
- Protecting infant industries
- Promoting industrialization
- Improving comparative position

Fighting Unemployment

The unemployed can form an effective pressure group for import restrictions. Let us understand the same with the help of an example.

Example: TV manufacturing industry India

In July 2020, the Indian government has imposed a ban on tv imports to help domestic industry and alongside raising employment. India could emerge as the next hub for manufacturing Tv not only for the Indian markets but also for the global market. This step was definitely in the right direction and would help in creating a global hub, and it also helped to create a strong ecosystem for the manufacturing of the products. This would encourage and support domestic manufacturing of all-size TV, more investment in the sector, and hence more job creation.

This example is reflecting one side of the situation. Import restrictions to create domestic employment

- May lead to retaliation by other countries,
- Affect large and small economies differently,
- Reduce import handling jobs,
- May decrease jobs in another industry,
- May decrease export jobs because of lower incomes abroad.

So, policy-makers need to be very cautious when deciding such matters as retaliation may not be fruitful for their economy in long run.

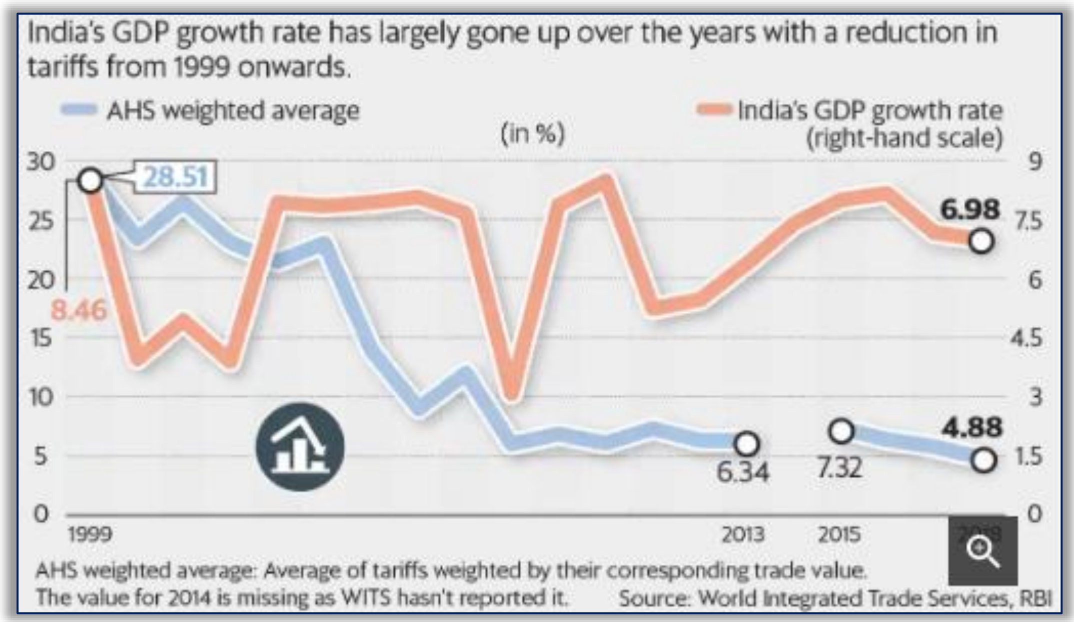
Protecting infant industries

The infant-industry argument holds that a government should shield an emerging industry from foreign competition by guaranteeing it a large share of the domestic market until it can compete on its own. The recent wave of protectionism and the US-China trade war point to a need to re-evaluate

India's trade policy. The argument in favor of higher tariffs or import substitution is that 'infant' domestic industries need to be protected.

Under an import substitution policy, a government uses trade tariffs as a policy instrument to encourage domestic industry, the idea being to substitute imports with domestic goods. This policy has been practiced by many countries, including India. The argument in favor of high tariffs is that in developing countries, industries are yet to develop and, therefore, need to be protected from international trade to ensure their development.

This is generally termed the "infant industry" argument and was often cited to justify the policy of tariffs, licenses, and quotas that predated the 1991 reforms. On the other hand, a low tariff regime has shown vast benefits over the years. This can be seen from the chart below:



The benefit of a low-tariff regime

Now after analyzing this data for the past two decades with this chart, the question arises that "Is the Infant Industry Argument Valid?" To some extent, the argument is valid as "infant" domestic industries would be hampered by imports of cheaper goods and commodities. The same can be seen in the Indian retail industry when organized players like Walmart entered in Indian industry. It has created a big impact on small retailers and eradicated some of them. But there is adequate empirical evidence, including from India's experience, that suggests protectionism and tariff barriers act as a disincentive for domestic industries to become competitive. Therefore, the government of any economy should try to weigh the decision before enforcing any restriction on any of the industries in the country.

Promoting Industrialization

Countries seek protection to promote industrialization because that type of production

- Can use surplus agricultural workers more easily,
- Brings in investment funds,
- Diversifies the economy,
- Brings faster growth than primary products do.

When a country shifts from agriculture to industry

- Output may increase if the agricultural workers produced little before,
- Demands on social and political services in cities may increase,
- Development possibilities in the agricultural sector may be overlooked,
- Industrial jobs may not be forthcoming.

Let us extend the previous example of the Indian economy to understand this better. Why is India not considered as attractive a destination for investment in manufacturing as say, Vietnam? The primary reason for India's failure to industrialize has been the failure to understand what constitutes competitiveness. In a country like India, industrial policies to achieve this goal were framed and implemented, with the public sector being given the leading role.

Nation monitors their absolute economic situations and compares their performance to other countries. Among their many practices to improve their relative positions. This is what should be done by emerging economies and underdeveloped economies for a faster growth perspective.

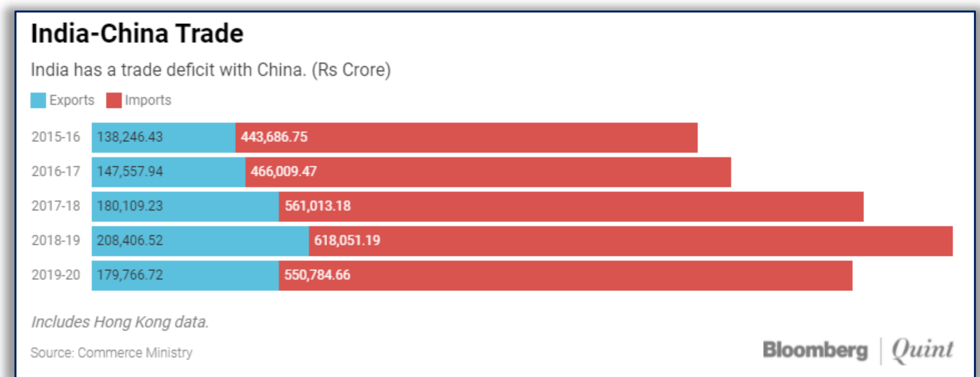
Improving Comparative Position

It depends upon four basic parameters:

- Balance-of-Trade Adjustments,
- Gaining comparable access to foreign markets,
- Using restrictions as a bargaining tool, and
- Controlling prices.

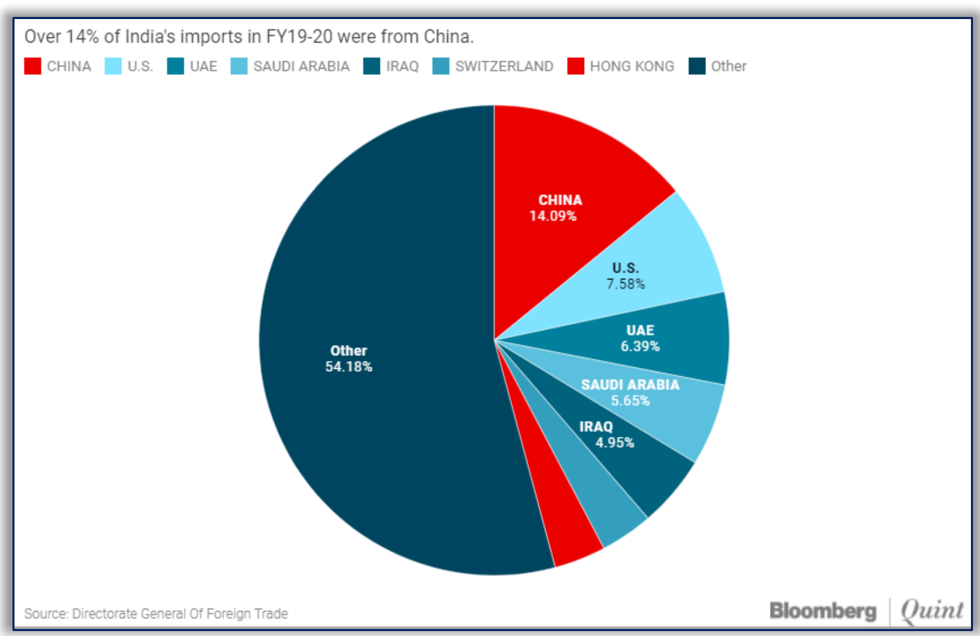
Example: India-China economic relations (A comparative study)

China is Asia's largest economy and the world's second-biggest with a GDP of about $13.6 trillion. India is No. 3 in Asia at $2.7 trillion. From supplying industrial components and raw materials to investments in India's startups and technology firms, China is India's biggest trading partner after the U.S. China accounted for over 5% of India's total exports in the financial year 2019-20 and more than 14% of imports. Meaning, India runs a huge trade deficit with China, the biggest exporter to India.

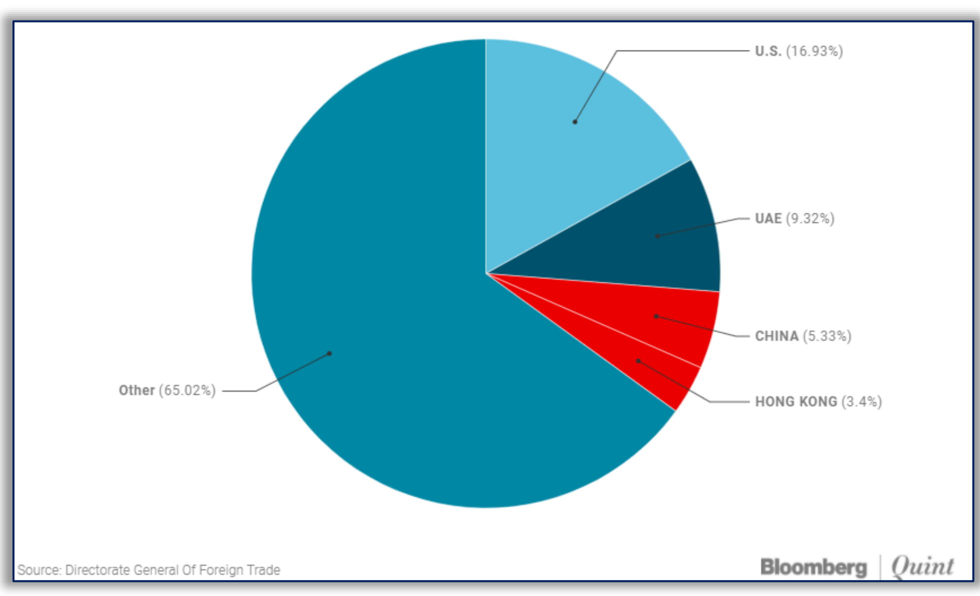


Chinese exports to India comprise smartphones, electrical appliances, power plant inputs, fertilizers, auto components, finished steel products, capital goods like power plants, telecom equipment, metro rail coaches, iron and steel products, pharmaceutical ingredients, chemicals and plastics, and engineering goods, among other things.

India's imports from China jumped 45 times since 2000 to reach over $70 billion in 2018-19. We can even see from the India import pie chart that import from China stands at 14 percent, highest among all other countries.



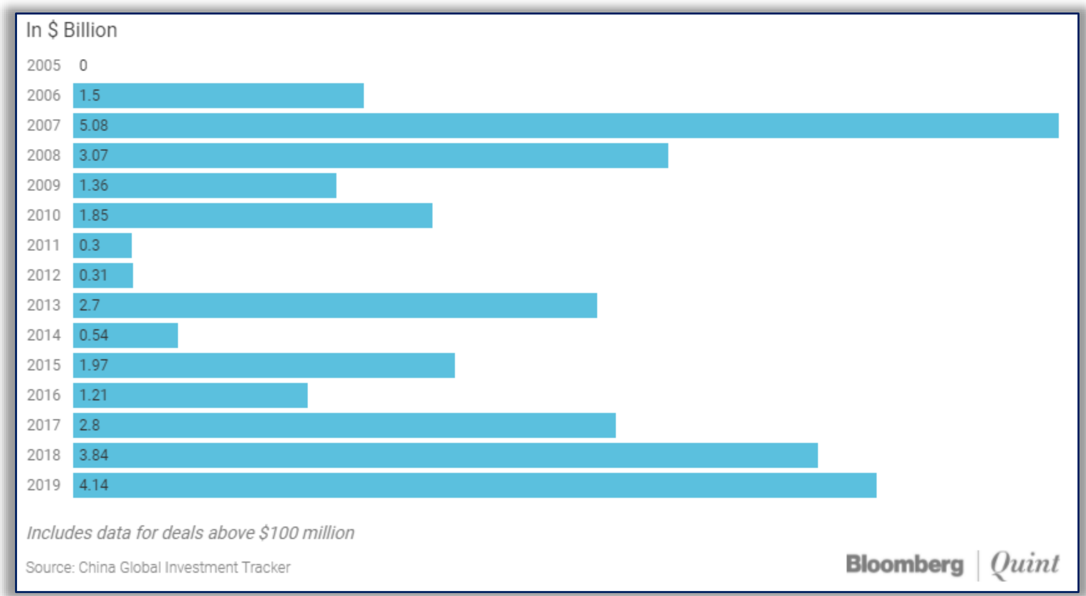
India Import Pie



India Export Pie

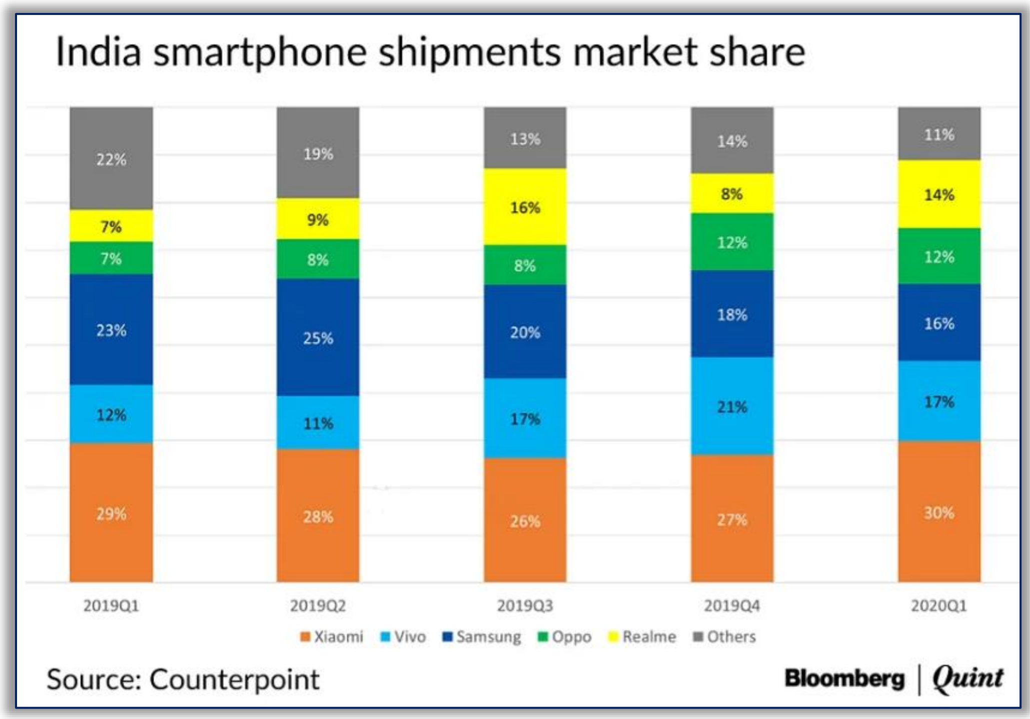
We can see through the export pie chart above that India is not able to maintain the same equation with China when it comes to export to it in comparison to its import from China.

Foreign direct investments from China came to metallurgical industries, renewable energy (solar panels), electrical equipment, automotive, and chemicals. China Global Investment Tracker showed Chinese FDI into India at $4.14 billion in 2019.



China FDI into India

There are roughly 800 Chinese companies in the domestic market. They have roughly 75 manufacturing facilities for smartphones, consumer appliances, construction equipment, power gear, automobiles, optical fibre, and chemicals. Chinese smartphone brands, led by Xiaomi, Vivo, and Oppo, are market leaders in India with an estimated 72% share put together, leaving Samsung and Apple behind. The same can be seen through the following chart.



This reflects the domination of Chinese smartphone manufacturers in the Indian market. Even in the tourism sector, Mainland China was the eighth-largest market for India in 2018 with nearly a 3% share in total arrivals. From just 1,371 arrivals in 1981, the number rose to 2.8 lakh in 2018, growing at an annualized rate of 32.4%, according to data available with the Tourism Ministry of India. Nearly 48% of the arrivals were for business purposes, and another 48% for leisure.

Indian policy-makers need to intervene if they want to reduce the trade deficit and improve its comparative position in the globe.

So far, we have cover economic rationales for governmental trade intervention, now let us also understand the non-economic rationale for government trade interventions.

Noneconomic Rationales for Governmental Trade Intervention

- Maintaining essential industries
- Promoting acceptable practices abroad
- Maintaining or extending spheres of influence
- Preserving national culture

In protecting essential industries, countries must

- Determine which one is essential,
- Consider costs and alternatives,
- Consider political and economic consequences

While talking about promoting acceptable practices abroad: trade limitations may be used to compel a foreign country to amend an objectionable practice. Governments use trade to support their spheres of influence-giving aid and credits to, and encouraging imports from, countries that join a political alliance. To help sustain a collective identity that sets their citizens apart from other nationalities, governments prohibit exports of art and historical items deemed to be part of their national heritage.

Self-Assessment

4. Which of the following is not an economic rationale for government trade intervention?

a) Fighting unemployment
b) Protecting established industry
c) Promoting industrialization
d) Improving comparative position

5. On which of the following basic parameters improving comparative position does not depend?

a) Balance-of-Trade Adjustments
b) Gaining comparable access to foreign markets
c) Using liberalization as a bargaining tool
d) Controlling prices.

6. Countries seek protection to promote industrialization because that type of production

a) Can use surplus agricultural workers more easily
b) Brings in investment funds
c) Diversifies the economy
d) All of the above.

7. Import restrictions to create domestic employment may:

a) Lead to retaliation by other countries
b) Affect large economies only
c) Increase import handling jobs
d) Not decrease jobs in another industry

8. Which of the following is not a noneconomic rationale for government trade intervention?

a) Maintaining non-essential industries
b) Promoting acceptable practices abroad
c) Maintaining or extending spheres of influence
d) Preserving national culture

9. In protecting essential industries, countries must consider __________and ________consequences.

a) Social and economic
b) Economic and political
c) Political and Social
d) None of these

Answer

4) B 5) C 6) D 7) A 8) A 9) B

5.3 Tariff and Non-tariff Barriers

In seeking to influence exports or imports, governments' choice of trade-control instrument is crucial because each may incite different responses from domestic and foreign groups. Major instruments of trade control are:

- Tariffs
- Nontariff Barriers

One way to understand these instruments is by distinguishing between those that directly influence export or import prices and those that directly limit the amount of a good that can be traded. Let us understand by starting with tariff barriers.

Tariffs: Direct Price Influences

A tariff is a tax levied on goods entering, leaving, or passing through a country. It is levied for protection or revenue. A tariff is levied on a per-unit basis, a value basis, or both.

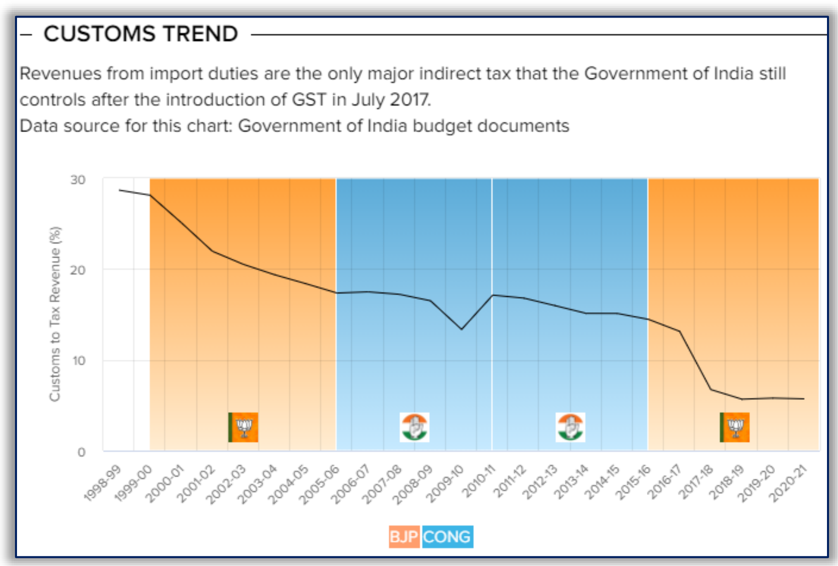
Types of tariffs are:

1. Tariffs collected by the exporting country are called export tariffs.
2. Tariffs collected by a country through which the goods pass are called transit tariffs.
3. Tariffs collected by importing countries are called import tariffs.

Tariffs also generate governmental revenue, but revenue is of little importance to developed countries because collection usually exceeds the yield. In many developing countries, though, they are a major source of revenue because they are often more easily collected than income taxes. Let us understand the same with the help of an example.

Example: Harley Davidson

It's a USA-based company, Harley-Davidson's annual revenue for 2019 was $ 5.3 billion and the company sold around 2,18,000 bikes. Mr. Donald Trump during his presidency has criticized India, saying it is one of the world's "highest taxing nations". India however slashed the customs duty on imported motorcycles like Harley-Davidson to 50 percent in 2020 after Trump called it "unfair" and threatened to increase the tariff on the import of Indian bikes to the US. Here we need to understand that Indian governments have used indirect tax as a source of income for themselves and it's been there for a while now. The same can be seen through the chart below:



India has been one of the countries levying the highest amount of import taxes on both cars and motorcycles. One of the reasons for this was to promote local manufacturing of automobiles. This has led to several auto manufacturers getting their bikes in as Completely Knock Down and Semi Knock Down as well as select Completely Build Up trade routes. High-end bikes however still come in via CBU and hence command astronomical prices.

An increase in import duties for the automotive industry could wreak havoc on strategies of not one or two, but several companies here, including the German trio (Mercedes-Benz, BMW, Audi), Skoda, Lexus, etc. Currently, completely built-up cars are subjected to import duties ranging between 100 percent to 60 percent, Whereas the duty levied on completely knocked down cars is 30 percent. Imported two-wheelers are also subjected to customs duties: 50 percent for completely built-up units and 25 percent for completely knocked down kits.

This may also prove to be a double whammy for auto companies, since any increase in these duties would translate into an increase in the price of their vehicles, thus taking a toll on their sales. This, then, would affect their ability to invest. Ford, one of America's biggest automakers, holds a market share of just about three percent in the Indian four-wheeler passenger vehicle segment. The other major manufacturer Chevrolet has now stopped selling cars in India and is using their Indian manufacturing plant to make cars only for exports.

Nontariff Barriers: Direct Price Influences

Governmental subsidies may help companies be competitive, subsidies offer direct assistance to companies to boost their competitiveness. We can even see agricultural subsidies; they are difficult to dismantle for any government. Subsidies are being offered especially to overcome market imperfections because they are the least controversial. But the question that arises over here is why do governments of various economies need to provide subsidies?

It is given for a variety of reasons, and in a variety of sectors, Like

- This could be to make items of daily need more affordable, such as food or fuel;
- Create an employable pool of educated people who would contribute to GDP growth (subsidized education);
- Provide a leg-up to certain sectors, or
- Boost industrialization in under-developed areas through tax exemptions.

There is no precise, cut, and dried answer to the question of whether the subsidy is good or bad - it depends on what subsidy one is talking about. Ambiguity arises if a subsidy is debated on an "ethical" plane; rather, the question ought to be asked in an "economic" sense: whether the subsidy is fulfilling the role it was designed for. The subsidy amount, after all, comes out of the taxes you and I pay. Let us understand the same with help of an example.

Example: Electric vehicle push in Indian economy

Since 2020, the Indian government under its ambitious electric vehicle policy has started providing subsidies of up to Rs. 30,000 for two-wheelers and up to Rs. 1.5 lakh for cars to promote faster adoption of electric vehicles. Such initiatives are taken up by the policy-makers once they want to implement certain schemes in their country.

Custom Valuation

Import tariff assessments depend on the product, price, and origin. It is difficult for customs officials to determine the honesty of import invoices. Let us understand the same with help of an example.

The United States tariffs on athletic footwear are different from those on sports footwear, and these are subcategorized by whether the sole overlaps the upper part of the shoe or not. Each type of accessory and reinforcement of the shoe's uppers is a different category. Administrating more than 13000 categories makes it a herculin task. Although classification differences may seem trivial, the disparity may cost or save companies millions of dollars.

Even the same can be seen in the following image, where two types of shoes are shown that are meant for a different purpose but look alike. It makes it very difficult for customs officials to figure out and charge accordingly.

Let us consider a very famous example of whether Marvel's X-men wolverines were toys or dolls.

Example: Whether Marvel's X-men wolverines were toys or dolls.

January 3, 2003, an American court of law officially ruled that the X-Men weren't humans. The decision was made by Judge Judith Barzilay, who presided over a case between the United States Court of International Trade and Toy Biz, Inc, a subsidiary of Marvel Comics. The ruling upheld a motion, posed by Toy Biz, that the X-Men weren't human — they were humanoid "mutants," a category likened by the defendant to robots and monsters. They argued that X-Men action figures weren't "dolls," because "to be properly classifiable as a 'doll' under the HTSUS (Harmonized Tariff Schedule of the United States), a toy figure must represent a human being." The US Court of International Trade had other ideas.

Now the question arises why was this such an important distinction for Toy Biz and the court? The answer for the same was import taxes. As dolls, X-Men figures were tied to tariffs of up to 12%. But as "nonhuman" toys, this figure was almost halved, to 6.8%. Such challenges need to be addressed by the organization that is operating in international markets.

Nontariff Barriers: Quantity Controls

Governments' regulations and practices affect the number of imports and exports directly. The various forms these typically take are:

Quotas:

A quota limits the quantity of a product that can be imported or exported in a given time frame, typically per year. Import quotas normally raise prices because they limit supplies and provide little incentive to use price competition to increase sales.

Buy Local

Buy local legislation sets rules whereby governments give preference to domestic production in their purchases. Given the enormity of government sectors in most economies, these preferences can be substantial.

Standards & Labels

Standards take a special place among non-tariff barriers. Countries usually impose standards on classification, labeling, 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. These standards are sometimes entered to protect the safety and health of local populations and the natural environment.

Specific Permission Requirements

Some countries require that potential importers or exporters secure permission from governmental authorities before conducting trade transactions, a requirement known as an import license. An importing country may require the prospective exporter to include a degree of local participation in the product or service. Options include a designated importer, a joint-venture company with majority local control, the requirement for complete local manufacture which may imply transfer of intellectual property.

Other types of trade barriers include

- Arbitrary standards,
- Importing, exporting, and currency licensing,
- Administrative delays
- Reciprocal requirements,
- Service restrictions.

In arbitrary standards, countries may require that importers or exporters secure governmental permission (an import or export license) before transacting trade. A foreign exchange control requires an importer to apply to a government agency to secure the foreign currency to pay for the product. Administrative delays create uncertainty and raise the cost of carrying inventory. International delays may occur not only to protect domestic producers but also for political reasons. Japanese companies reported such delays in China after Japan and China clashed over the ownership of islands in the East China Sea. Reciprocal requirements talk about barter trade. The WTO estimates that 15 percent of world trade involves some type of barter.

Four main reasons why trade in services is restricted are

- Essentiality like media, communications, utilities
- Preference for not-for-profit operations, hospital and health services
- Different professional standards- electricians, lawyers
- Immigration.

Self-Assessment

Multiple-choice questions

10. In addition to protection, tariffs serve to ________.
    a) generate revenue
    b) subsidize exports
    c) subsidize imports
    d) increase consumption

11. In international trade, what is a quota?
    a) a guarantee by one country to buy some minimum amount from another
    b) a quantitative limit on the amount of a product that can be imported or exported
    c) a countertrade arrangement that establishes the value of imports and exports
    d) a bilateral agreement calling for mutual access to markets

12. The U.S. catfish industry successfully petitioned the U.S. government to require that catfish variety imported from Vietnam be labeled as "tra," "basa," or "pangasius." This is an example of which of the following?
    a) A tariff
    b) A nontariff barrier
    c) A direct price influence
    d) None of these

True/False

13. The most common type of tariff is the export tariff.

True

False

14. The international regulatory situation for trade is becoming more, rather than less, complex.

True

False

15. A quota is a quantitative limit on the amount of a product that can be traded.

True

False

Answer

10) A 11) B 12) B 13) False 14) True 15) True

Summary

The term protectionism, when applied to international trade, refers to governmental restrictions and incentives to affect trade flows.

A few of the important challenges that are faced by firms while operating internationally are language barriers, cultural differences, managing global teams, currency exchange & inflation rates, and foreign politics, policy, and relations.

The infant-industry argument holds that a government should shield an emerging industry from foreign competition by guaranteeing it a large share of the domestic market until it can compete on its own.

Governments use trade to support their spheres of influence-giving aid and credits to, and encouraging imports from, countries that join a political alliance.

A tariff is a tax levied on goods entering, leaving, or passing through a country. It is levied for protection or revenue.

Governmental subsidies may help companies be competitive, subsidies offer direct assistance to companies to boost their competitiveness. We can even see agricultural subsidies; they are difficult to dismantle for any government.

Import tariff assessments depend on the product, price, and origin.

Keywords

Quota limits the quantity of a product that can be imported or exported in a given time frame, typically per year. Import quotas normally raise prices because they limit supplies and provide little incentive to use price competition to increase sales.

Protectionism refers to government policies that restrict international trade to help domestic industries.

A tariff is a tax levied on goods entering, leaving, or passing through a country. It is levied for protection or revenue.

Transit Tariff is collected by a country through which the goods pass.

Import Tariff is a tax collected by importing countries.

Review Questions

1. Explain the rationale for and problems with making the infant-industry argument work as intended.

2. What are the disadvantages of import restrictions in regards to creating domestic employment opportunities?

3.Briefly discuss the four noneconomic rationales for governmental intervention in the free movement of trade

4. Describe and compare the different types of tariffs

5. List and define the types of nontariff barriers that limit the quantity of goods traded

6. In a short essay, list and discuss the nontariff barriers that relate to direct price influences: subsidies, aid and loans, customs valuations, and other direct price influences.

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Unit 06: Economic Integration and Co-operation

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Introduction
6.1 Economic Integration
6.2 Types of Regional Trade Agreements
6.3 World Trade Organization
6.4 Important Functions Performed by World Trade Organization
Summary
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Answer for Self Assessment
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Further Reading

Objectives:

After studying this unit, you should be able to

- outline the regional economic integration.
- illustrate the global economic integration
- illustrate the role of the World Trade organization in international trade
- outline the importance of the World Trade organization in international trade

Introduction

In previous units, we have covered how the mobility of capital, technology, and people affect a country's trade and the relative competitive positions of domestic firms and industries. Imbalances in the mobility of factors of production are often addressed in strategies for cross-national integration. The question that needs to be addressed here is how do Nations and regions combine forces to give and gain the assistance they need to prosper together?

The answer to the same is economic integration. So let us understand the same with the help of definition.

6.1 Economic Integration

It is a term used to describe the political and monetary agreements among nations and world regions in which preference has been given to member countries. It is an arrangement among nations that typically reduces or eliminates trade barriers and coordinates monetary and fiscal policies. Economic integration aims to reduce costs for both consumers and producers and to increase trade between the countries involved in the agreement.

There are three primary ways to approach such agreements:

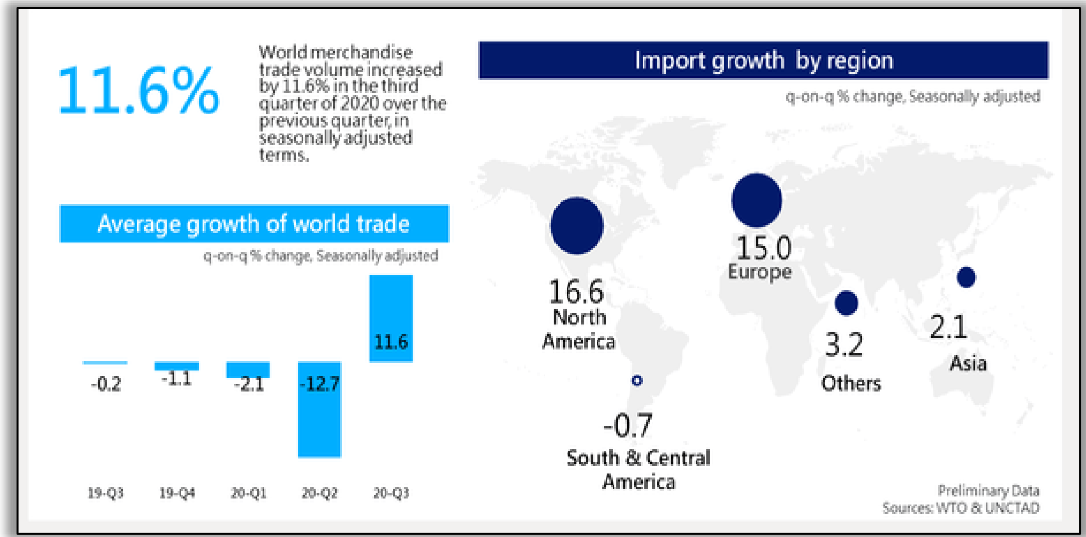
- Global Integration
- Bilateral Integration
- Regional Integration

Whether global, bilateral, or regional, trade groups are an important influence on multi-national companies' strategies. They can define the size of the regional market and the rules under which a

company must operate. An increase in market size is their single most important reason for existing.

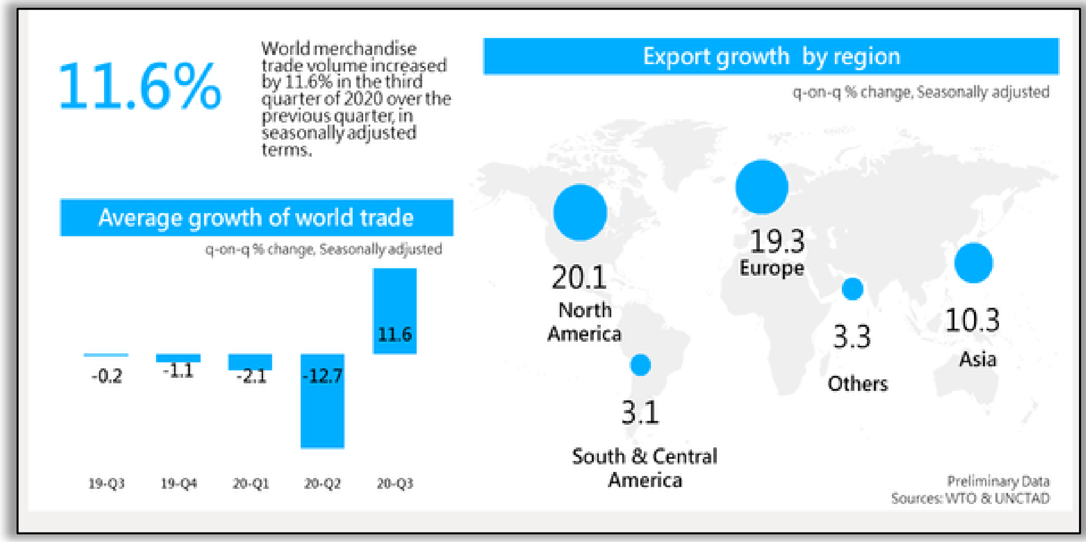
Global Integration

Countries from all over the world decide to cooperate through the World Trade Organization. It is because of this global integration that situation in pandemic was managed well. Countries have helped each other in such crisis times. The same can be seen with the data shown in the charts below for region and export growth by region.



Merchandise Trade Volume

This chart reflects the import growth of various regions and validates the importance of global integration. The situation has become like this just because countries have shattered the barriers and collaborated with other countries in a conducive manner.



Merchandise Trade Volume

This chart interprets the export growth by region of the globe. Again, a promising sign can be seen here even in a time of crisis like pandemic COVID-19. Such growth is a result of global integration. Let us understand the same with the help of an example.

State of the Indian economy

A group of industrialists opposed to the economic reforms of 1991 in India. These industrialists were worried about foreign competition and lobbied with the government to keep imports and foreign firms away. Foreign competition came anyway. In response, the domestic industry became more efficient, consumption and exports grew, and groups of industrialists opposing the global firms benefitted from foreign capital and international markets.

The global pandemic is being blamed on capitalism and globalization, accompanied by the usual crowd of mercantilists and isolationists calling for protectionism. The tragedy for many developing countries is that they still have a long way to realize the income and productivity benefits of global economic integration. Globalization has not yet reached its full potential.

In the absence of American leadership, India and other developing countries need to champion the cause of WTO and global trade. By integrating with the global economy, India has helped move 300 million people moving out of abject poverty. Not to mention the added advantage of getting rid of clunky Ambassador cars.

The persistent failures of India's import substitution policy are well documented. Just look at the anemic GDP growth from 1960 to 1990 highlighted by an inefficient domestic industry and shoddy consumer products. Some of the policymakers and business leaders in India seem to like exports and hate imports, but you can't have one without the other. India can even learn this lesson from its neighbour like China.

China, the world's largest exporter, exported $2.5 trillion of goods and services in 2019. But the country also imported $2.1 trillion worth of goods and $500 billion worth of services. Integration into global supply chains implies both imports and exports.

Globalization is not just the trade of goods and services – the second pillar of globalization is a cross-border investment. India does not have the domestic savings pool to support the massive investment needed for physical and social (i.e, health and education) infrastructure. While India needs stable long-term investment, North America and Europe want decent investment returns to support their aging populations. A durable and predictable policy regime will go a long way in facilitating stable and long-term capital flows into India.

It comes on the back of several recent reforms announced by the Indian government to boost investment, including aggressive cuts in corporate taxes, relaxation of foreign investor rules, and the biggest privatization drive in more than a decade. It's a positive signal of reform agenda and a step toward making India attractive, in the context of the golden opportunity of manufacturing shift from China. This could help an economy like India to be on the path of global integration.

Bilateral Integration

Two countries decide to cooperate more closely together, usually in the form of tariff reductions. It can be between two individual countries or may involve one country dealing with a group of other countries. Let us understand the same with the help of an example.

India and Bangladesh building trade relations

India, the world's biggest rice exporter, offers a steep discount to supplies from rivals Thailand and Vietnam to cut its surplus after a bumper harvest. Bangladesh, the world's third-biggest rice producer with an output of almost 35 million tons a year, relies on imports from time to time to cope with shortages caused by natural disasters such as floods or drought.

We can even consider where relations between two countries can be in trouble due to tariff war. A recent example of the same was between China and the USA. We can even consider another example of India and the USA where tariffs play a spoilsport for both countries.

India and The United States of America trade relations in recent past

Apple incorporation (a US-based company) faced the price hike solely based on customs duty hike on imported mobile phones and chargers in 2020. Mobile phones were earlier exempted from 10% service welfare cess, but it was then re-imposed on imported handsets above the existing 20% basic customs duty in India. Under the Trump administration, bilateral tensions increased over each side's tariff policies. India has relatively high average tariff rates, especially in agriculture. It can raise its applied rates to bound rates without violating its commitments under the WTO (World Trade Organization), causing uncertainty for U.S. exporters.

The United States and several other countries have requested to join various WTO dispute consultations against India related to its technology tariffs, questioning its compliance with the WTO Information Technology Agreement (ITA).

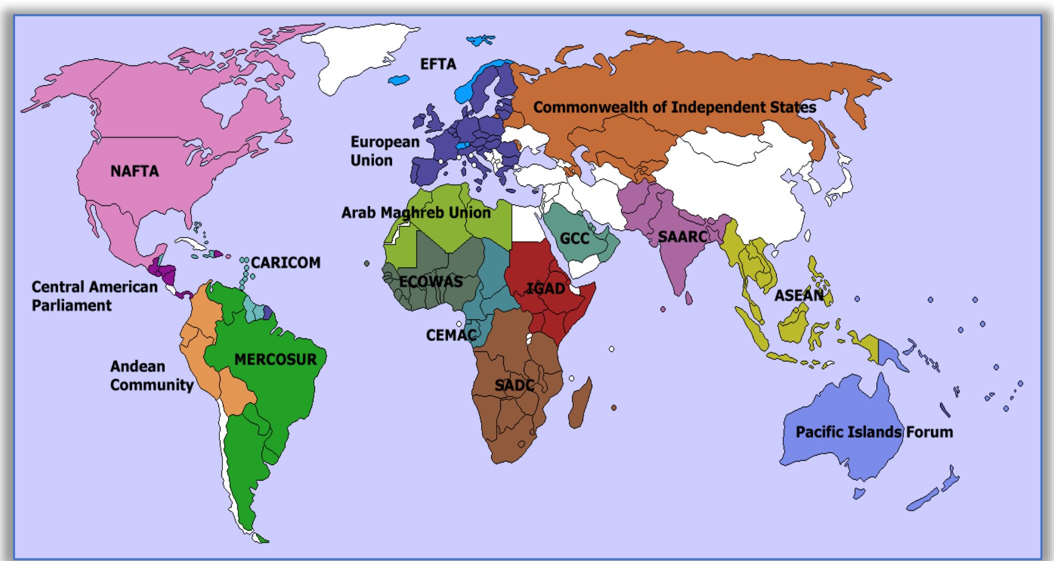
India opposes the 25 percent steel and 10 percent aluminum national security-based 'Section 232' tariffs that the Trump administration imposed in 2018. India repeatedly delayed applying planned retaliatory tariffs against the United States in hopes of resolving the issue bilaterally. After India lost its eligibility for the U.S. Trade Preference Program, India imposed higher tariffs of 10 percent to 25 percent, affecting about USD 1.32 billion of U.S. exports, such as nuts, apples, chemicals, and steel, the report stated, adding that the two sides are challenging each other's tariffs in the WTO.

Regional Integration

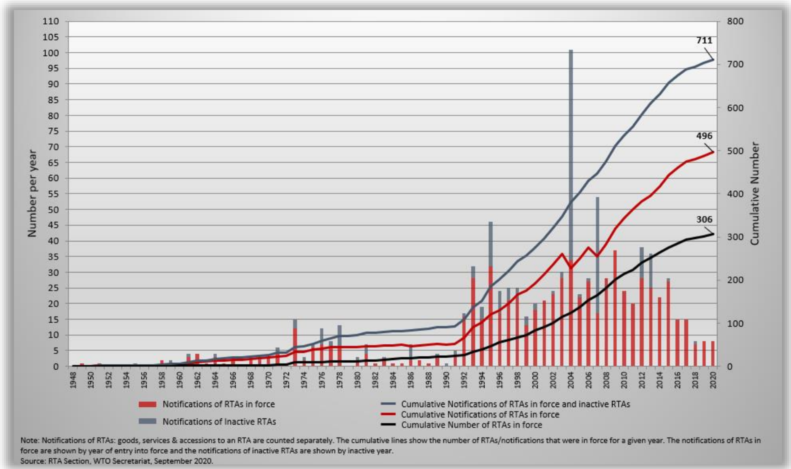
A group of countries located in the same geographic proximity decides to cooperate. Regional integration is confined to a region and involving more than two countries. Regional trading agreements refer to a treaty that is signed by two or more countries to encourage the free movement of goods and services across the borders of its members. The agreement comes with internal rules that member countries follow among themselves. Some of the crucial regional trade agreements are:

- European Union (E.U.)
- The North American Free Trade Agreement (NAFTA)
- Association of Southeast Asian Nations (ASEAN)
- Free Trade Area (AFTA)

It's logical that most trade groups contain countries in the same area of the world. Neighbouring nations tend to ally for several reasons, like the distance that goods need to travel are short, consumer's tastes are likely to be similar, and distribution channels can easily be established. Let us go through the regional organization's map to have better clarity on regional integration.



As of 20 September 2020, 306 RTAs were in force. These correspond to 496 notifications from WTO members, counting goods, services, and accessions separately.



The primary reason to establish a regional trade group is to increase market size. There are two types of RTAs from the standpoint of tariff policies

6.2 Types of Regional Trade Agreements

- Free Trade Area
- Custom Union

Free Trade Agreement

The goal of an FTA is to abolish all tariffs between member countries. It usually begins modestly by eliminating them on goods that already have low tariffs. There is typically an implementation period during which all tariffs are eliminated on all products included in the agreement.

Custom Union

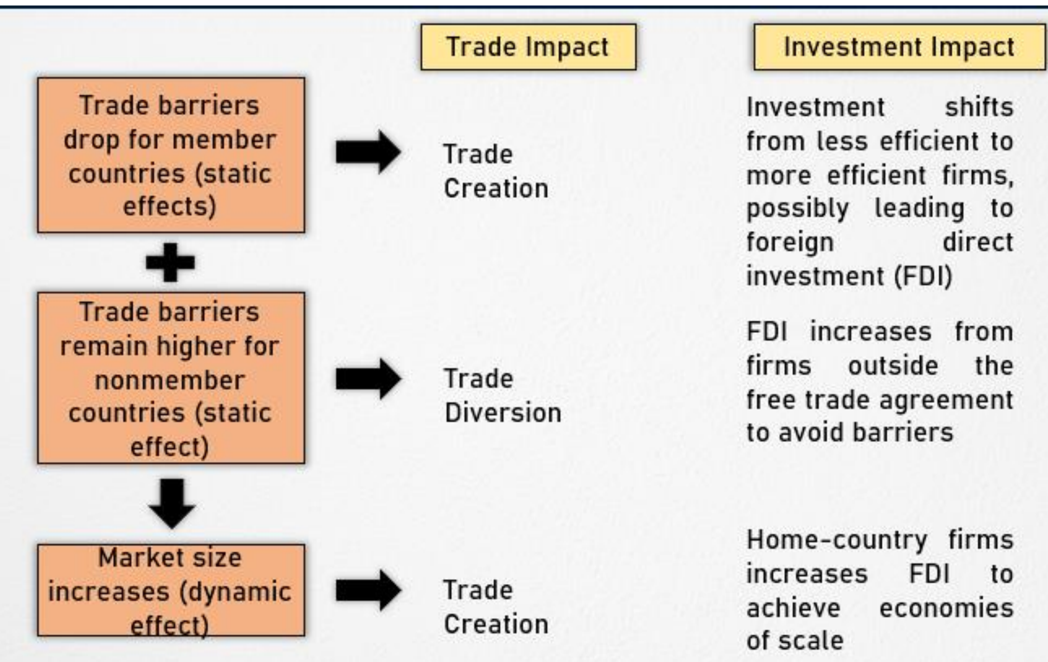
In addition to eliminating internal tariffs, member countries levy a standard external tariff on goods being imported from non-members in order to establish a customs union. For example, when E.U. was organized in 1957, it began to remove internal tariffs among members state. But in 1967, it eliminated the remaining internal tariff. Instead, it established a standard external tariff, meaning that goods shipped into the one-member country from abroad are free from tariffs in the rest of the member countries.

Another essential aspect that needs to be considered here is the common market.

Common Market

This can be said that adding free mobility of production factors to a customs union results in a common market. Beyond the reduction of tariffs and non-tariff barriers, countries can enhance their cooperation in various ways. Like E.U. also allows free mobility of production factors such as labor and capital. This means that labor for example is generally free to work in any country in the common market without restriction.

Impact of Free Trade Agreement



The static effect may develop when either of two conditions occurs:

- ***Trade Creation:*** production shifts to more efficient producers for reasons of comparative advantage, allowing consumers access to more goods at lower prices than would have been possible without integration.
- ***Trade diversion***: trade shifts to countries in the group at the expense of trade with other countries, even though the non-member companies might be more efficient in the absence of trade barriers.

6.3 World Trade Organization

The World Trade Organization (WTO) is the only global international organization dealing with trade rules between nations. It is an organization for trade opening. It is a forum for governments to negotiate trade agreements. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to help producers of goods and services, exporters, and importers conduct their business. It operates a system of trade rules. Essentially, the WTO is a place where member governments try to sort out the trade problems they face with each other.

Origin of World Trade Organization

The World Trade Organization came into being in 1995. One of the youngest international organizations, the WTO, is the successor to the General Agreement on Tariffs and Trade (GATT) established in the wake of the Second World War. So, while the WTO is relatively young, the multilateral trading system that was originally set up under the GATT is over 70 years old.

The Uruguay Round - which culminated in the signing, in April 1994, of several agreements was one of the complete sets of negotiations of the 47-year old GATT (General Agreement on Tariffs and Trade). Apart from the core agenda on the dismantling of tariff barriers, the Round concluded a series of novel agreements; The GATS (General Agreement on Trade of Services), TRIPS (Trade-Related Aspects of Intellectual Property Rights), a new deal replacing the Multifibre Agreement of 1974, and the TRIMS (Trade-Related Investment Measures). Finally, the last Agreement, of more general scope, led to the former GATT giving birth to the current WTO as of 1995.

Trade Without Discrimination

This principle of trade without discrimination was embodied in GATT's most-favored-nation clause. It states that once a country and its trading partners have agreed to reduce a tariff, that tariff cut was automatically extended to every other member country, irrespective of whether it was a signatory to the agreement.

Its member governments run the WTO. All significant decisions are made by the membership as a whole, either by ministers (who usually meet at least once every two years) or by their ambassadors or delegates (who meet regularly in Geneva). It is an international organization whose primary purpose is to open trade for the benefit of all.

The WTO agreements are lengthy and complex because they are legal texts covering a wide range of activities. But several simple, fundamental principles run throughout all of these documents. These principles are the foundation of the multilateral trading system. First, the WTO provides a forum for negotiating agreements to reduce obstacles to international trade and ensure a level playing field for all, thus contributing to economic growth and development.

The WTO also provides a legal and institutional framework for the implementation and monitoring of these agreements and settling disputes arising from their interpretation and application. The WTO currently has 164 members, of which 117 are developing countries or separate customs territories.

6.4 Important Functions Performed by World Trade Organization

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

India and South Korea bilateral trade agreements

The Comprehensive Economic Partnership Agreement (CEPA) between the two countries was implemented in January 2010. Under the Comprehensive Economic Partnership Agreement between India and Korea, India liberalized 69.5 percent of its tariffs and Korea 88.6 percent. Rates were also reduced on around 13.9 percent of India's tariffs and 4.4 percent of Korea's tariffs.

The Agreement's other provisions include sanitary measures and technical barriers to trade, safeguards, dispute settlement, and customs cooperation. Trade between both parties had increased by 70 percent in ten years, from USD 12 billion in 2009 to USD 21.3 billion in 2018. India's imports from Korea almost doubled from around USD 8 billion in 2009-2010 to USD 16 billion in 2018-2019, although exports to Korea had increased marginally, resulting in an increasing trade imbalance.

Therefore, India sought concessions for its rice exports to South Korea as Seoul levies a whopping 513% tariff on imported rice and buys rice from only five countries under its tariff rate quota regime. New Delhi would also push for Seoul to allow imports of grapes and pomegranates, and eggplant and do away with the requirement of sending inspectors before importing mangoes.

Korea said that the Agreement goes beyond each party's WTO commitments in many areas. Investment flows between both countries have also grown by 124 percent over 2009-2019, from USD 349 million to USD 782 million. The parties were negotiating to add to the Agreement provisions on goods, services, and investment to maximize benefits for both countries. This is how World Trade Organization functions to help member countries to have a win-win situation for each.

Similarly another example of the European Union can be seen, The Department of Trade and Industry (DTI), together with the embassies of Norway and Switzerland, is urging Philippine-based exporters to take advantage of the free trade agreement (FTA) between the Philippines and European Free Trade Association (EFTA).

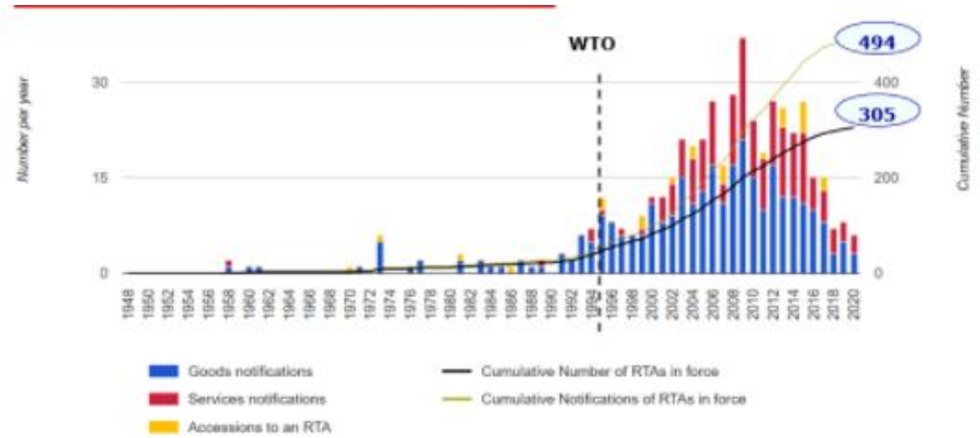
There's a feature of the agreement that facilitates trade. It's the origin declaration scheme, whereby the certificates of origin is greatly facilitated, and also there's an exporter accreditation program. This FTA allows raw materials of finished products to be sourced from other countries as long as they are manufactured and shipped from the Philippines to EFTA.

The Philippines said that the Agreement is progressive in terms of scope and coverage and ranges from investment to intellectual property rights, trade in goods, and government procurement. The total trade between both parties has increased by 2.4 percent between 2018 and 2019, from USD 802

million to USD 821 million. In addition, the Philippines' exports to EFTA grew by 17 percent between 2018 and 2019, from USD 370 million to USD 434 million.

On behalf of EFTA, Switzerland noted an increase in bilateral trade, with the Philippines' exports to EFTA up from USD 250 million in 2017 to over USD 300 million in 2019. By providing stable and predictable trading conditions, the Agreement provides a significant potential to further boost trade between the two traders. These examples reflect the importance of the functions performed by the World Trade Organization.

The WTO & RTA in Force



We can see that since the inception of WTO, the number of regional trade agreements has increased significantly. They are to cover all of the trade of the signatories substantially, as per the WTO rules. However, the WTO rules allow for lesser coverage of RTAs concluded among developing countries only. All rest upon the foundation of the rules of the multilateral trading system, the WTO rules. They do not seek to re-negotiate all of the rights and obligations that the signatories have under the WTO agreements.

On the contrary, primarily, they add to them. Thus, the parties' WTO rights and obligations remain largely intact. Let us understand the role of World Trade Organization in these regional trade agreements with the help of an example.

In 2020, WTO launched the first online regional trade policy course for Arab and Middle Eastern states.

The course was organized by the WTO's Institute for Training and Technical Cooperation (ITTC) and was opened by its Director, Bridget Chilala, who welcomed the high number of women among the participants (12 out of 16), which was the highest registered for a trade policy course for this region. The course was aimed to reproduce most of the training components offered by face-to-face regional trade policy courses.

It provides intermediate-level training (known as "level 2" in the WTO progressive learning strategy) and is specifically designed for government officials working on trade-related issues which have already undertaken basic WTO training.

Future Outlook for World Trade Organization

It largely depends upon its members that have a say in the overall working of the organization. Unfortunately, in the recent past, we have seen a change in the viewpoint of the USA towards WTO. Frustration with hyper-globalization, China's "economic imperialism," and a seemingly broken world trading system are boiling over into tough calls for the United States to withdraw from the World Trade Organization (WTO), which would have potentially disastrous implications the country is carried out.

For the first time since 2005, lawmakers from both parties and both houses of Congress are pushing to pull the United States out of the trading body it helped create and which was the culmination of decades of post-war efforts to boost free trade and economic integration. By law, the United States has a chance to vote every five years on staying inside the WTO, but staying on board was such a no-brainer in recent years that no such resolution was even presented.

If the United States were to pull out of the system, it helped build, and the implications would be dire. Other countries would be able to discriminate against U.S. goods and services with no limits.

As a result, tariffs would almost certainly rise, and export markets shrink. Meanwhile, others like China and the European Union would increasingly be able to write the rules of the future economy, from data protection and privacy to intellectual property and state subsidies.

The reason, for which the U.S. has thought of withdrawing itself from WTO, lies with the decision that WTO has taken in the recent past against the U.S., while settling tariff dispute between America and China. The World Trade Organization ruled that additional tariffs imposed in 2018 by the United States on Chinese goods violated international trading rules, a blow to the Trump administration's trade war against the world's second-largest economy. A three-person panel of WTO trade experts said Washington broke with global regulations in 2018 when it slapped more than $200 billion in levies on a slew of Chinese goods. Since March 2018, the U.S. has imposed tariffs on $400 billion in Chinese exports.

The institution was under considerable pressure. Negotiations on a comprehensive development agenda have foundered due to disagreements over agricultural subsidies and intellectual property rights. The criticisms of the organization vary. Farmers and labor groups accuse the WTO of focusing too narrowly on corporate interests, environmentalists worry about deregulation, and U.S. policymakers allege that the institution has failed to handle Chinese abuses.

Even with Doha stalled, WTO talks have continued through what is known as plurilateral negotiations, or agreements among subsets of WTO members. Plurilateral deals are easier to negotiate, as they are narrower in focus and not all members are bound by their terms.

If we go by the following chart, we can see the number of disputes in which various member countries are involved in the last two decades.

This reflects how member countries are putting their viewpoints on various trade-related activities taken up by different group members. Hence WTO and other such world institutions need to draw a path for themselves to keep their identity intact without getting biased towards any member country.

Summary

Economic Integration term used to describe the political and monetary agreements among nations and world regions in which preference is given to member countries. It is an arrangement among nations that typically includes reducing or eliminating trade barriers and coordinating monetary and fiscal policies.

Economic integration aims to reduce costs for both consumers and producers and to increase trade between the countries involved in the agreement. The three primary ways of economic integration are global, bilateral and regional agreements.

The goal of an FTA is to abolish all tariffs between member countries. It usually begins modestly by eliminating them on goods that already have low tariffs. Then, there is usually an implementation period during which all tariffs are stopped on all products included in the agreement.

The addition of free mobility of production factors to a customs union results in a common market.

The World Trade Organization (WTO) is the only global international organization dealing with trade rules between nations. It is an organization for trade opening. It is a forum for governments to negotiate trade agreements.

The principle of trade without discrimination was embodied in GATT's most-favored-nation clause. It states that once a country and its trading partners have agreed to reduce a tariff, that tariff cut was automatically extended to every other member country, irrespective of whether it was a signatory to the agreement.

Keywords

Economic Integration: It is the term used to describe the political and monetary agreements among nations and world regions in which preference is given to member countries.

Free Trade Agreements: The goal of an FTA is to abolish all tariffs between member countries. It usually begins modestly by eliminating them on goods that already have low tariffs. Then, there is typically an implementation period during which all tariffs are stopped on all products included in the agreement.

Trade Creation: production shifts to more efficient producers for reasons of comparative advantage, allowing consumers access to more goods at lower prices than would have been possible without integration.

Trade diversion: trade shifts to countries in the group at the expense of trade with other countries, even though the non-member companies might be more efficient in the absence of trade barriers.

Bilateral Integration: Two countries decide to cooperate more closely together, usually in tariff reductions.

Global Integration: Countries from all over the world decide to cooperate through the World Trade Organization.

Self-Assessment

1. ___________ integration is the political and economic agreements among countries that give preference to member countries to the agreement.
   - A. Global
   - B. Economic
   - C. Bilateral
   - D. Regional

2. Country A and Country B make an agreement to cooperate more closely and implement tariff reductions. Which of the following best describes this agreement?
   - A. Double commodity integration
   - B. Multilateral integration
   - C. Regional integration
   - D. Bilateral integration

3. The European Union is an example of ________ integration.
   - A. Regional
   - B. Relative
   - C. Global
   - D. Bilateral

4. Global integration occurs as countries from all over the world decide to cooperate through the ________.
   - A. EU
   - B. NAFTA agreement
   - C. WTO
   - D. CARICOM

5. Which of the following statements most accurately describes the relationship between trading groups and MNEs?
   - A. Trading groups have no influence on the size of the regional market.
   - B. Regional trading groups can define the rules under which companies must operate within that region.

C. Companies never need to change their organizational structure to take advantage of regional trading groups.
D. Regional trading groups do not influence an MNE's strategy since they operate worldwide.

6. Anderson Enterprises is a U.S. firm that manufactures light fixtures for commercial and residential consumers. Anderson is looking to expand internationally, so the firm should most likely ________.
A. Focus on developing new recruitment strategies and selection tests
B. Change their organizational structure to fit the norms of the foreign country
C. Disregard changes in trading groups because they have little effect on a company
D. Look to expand beyond the triad regions currently controlled by the top 500 MNEs

7. Baldani Manufacturing, an Italian firm, plans to expand into Asia. However, in order to take advantage of regional trading groups, Baldani will most likely need to change its ________.
A. Operating strategies
B. Selection test methods
C. Bilateral trade agreements
D. Economic integration methods

True/False

8. Regional integration is better known as global integration through the World Trade Organization.(True/False)

9. Most MNEs generate a large portion of their revenues in their home regions.(True/False)

10. The ________ clause embodied the fundamental principle of GATT—trade without discrimination.
A. Most-favoured-nation
B. Non-tariff barriers
C. Free rider
D. Normal trade relations

11. Which of the following accurately identifies a difference between GATT and the WTO?
A. GATT could enforce member compliance with agreements, but the WTO cannot.
B. At its inception, GATT had more member nations than the WTO currently has.
C. GATT withdrew the most-favoured-nation clause, but the WTO reinstated it.
D. GATT rules did not cover trade in services, but the rules of the WTO do.

12. Under the WTO agreement, ________.
A. A dispute resolution mechanism allows countries to bring grievances to the WTO against countries that levy inappropriate trade discrimination measures.
B. There is no dispute resolution mechanism except for trade involving environmental products.
C. Countries are allowed to place trade barriers on member countries with no particular justification because, like GATT, the WTO has no enforcement mechanism
D. Tariffs are permitted to be levied by developed countries against developing countries but not against each other.

13. Most trade agreements contain countries in the same area of the world. Why is this so?
A. The distances that goods need to travel between such countries are short.
B. Distribution channels are not quickly established in adjacent countries.
C. Adjacent countries are reluctant to coordinate policies.
D. Neighboring countries usually lack a shared history and interests.

14. The goal of a ________ is to abolish all tariffs among member countries.
A. Customs union
B. Common market
C. Free trade agreement
D. Common internal tariff

15. Trade shifting to countries within a regional trade agreement at the expense of trade with countries not in the agreement is called ________.

A. A dynamic effect
B. Trade creation
C. Trade diversion
D. Economy of scale

Answer for Self Assessment

1.	B	2.	D	3.	A	4.	C	5.	B
6.	B	7.	A	8.	False	9.	True	10.	D
11.	D	12.	A	13.	A	14.	C	15.	C

Review Questions

1. In a brief essay, explain the roles of the World Trade Organization and the United Nations in international trade.

2. Why is geography important to most regional trade agreements? Provide examples of RTAs to illustrate your answer.

3. Describe the different types of regional economic integration and give an example of each type.

4. Explain the static effects and dynamic effects of economic integration. What is the difference between trade creation and trade diversion resulting from economic integration?

5. What is the difference between a free trade agreement and a customs union? Provide examples of each in your answer.

Further Reading

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Unit 07: International Financial Markets

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Objectives:
Introduction:
7.1 The International Monetary Fund
7.2 Foreign Exchange Market
7.3 Exchange-Rate Determinants
Self-Assessment
Answers for Self Assessment
Summary
Keywords
Review Questions
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Objectives:

After studying this unit, you should be able to

- illustrate the role of the International Monetary Fund in international business operations
- interpret the foreign exchange market mechanism in international business
- demonstrate the working of exchange rate arrangement in global business operations
- identify the major determinants of exchange rates
- illustrate the exchange rate movements and their impact

Introduction:

The IMF was conceived in July 1944 at the United Nations Bretton Woods Conference in New Hampshire, United States. The 44 countries in attendance sought to build a framework for international economic cooperation and avoid repeating the competitive currency devaluations that contributed to the Great Depression of the 1930s. The IMF's primary mission is to ensure the stability of the international monetary system—the system of exchange rates and international payments that enables countries and their citizens to transact with each other.

The International Financial Market is where financial wealth is traded between individuals (and between countries). It can be seen as a comprehensive set of rules and institutions where assets are traded between agents in surplus and agents in deficit and where institutions lay down the rules.

The financial market comprises the markets (stock market, bond market, currency market, derivatives market, commodity market, and money market), the institutions which work in them with different aims and functions (Central Bank, Ministry of Economy and Finance), as well as direct/indirect policies orientated to making the market the place (not necessarily a physical place and not necessarily ruled but regulated) where the exchange between surplus and deficit units is carried out as efficiently as possible.

About policies, consideration must be given to those connected with monetary, fiscal, and more structural approaches, as well as those directly associated with the governance of the market itself.

7.1 The International Monetary Fund

It 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 worldwide.

In 1944, toward the close of World War II, the central allied governments met in Bretton Woods, New Hampshire, to determine what was needed to bring economic stability and growth to the post-war world. As a result of those meetings, the IMF came into official existence on December 27, 1945, to promote exchange rate stability and facilitate the international flow of currencies.

Objectives of International Monetary Fund

- Foster global monetary cooperation,
- Secure financial stability,
- Facilitate international trade,
- Promote high employment & sustainable economic growth, and
- Reduce poverty around the world

Let us see how IMF fulfills these objectives with the help of few examples.

Example: IMF calls for debt relief beyond the world's poorest countries during a pandemic to help them survive.

The debt treatment framework endorsed by G20 leaders applied to 73 countries that were eligible for a temporary freeze in official bilateral debt payments during the pandemic. In addition, the head of the International Monetary Fund called for prompt and effective implementation of a new G20 framework set up to help the world's poorest countries reach permanent debt relief. This move by IMF fulfills one of its objectives of securing financial stability.

The G20 Debt Service Suspension Initiative has helped 44 countries defer $5 billion to spend on mitigating the COVID-19 crisis. Still, its efficacy has been limited by the absence of private creditors and China's failure to include all state-owned institutions. But many poorer countries have been reluctant to ask for a freeze in government bond payments, worried that doing so could harm their ability to borrow money in the future. Therefore, the role of IMF becomes important at such stages to reassure countries for using such measures to counter the impact of the crisis that keeps on coming from time to time. This example reflects global monetary cooperation supported by IMF.

Example: IMF cuts Asia's growth forecast for the year 2020, warns of pandemic-driven risks.

While the IMF upgraded the 2021 growth forecast, it warned the recovery would be sluggish and patchy, with countries dependent on tourism seen taking a particularly hard hit. Although China's recovery can boost regional trade, weak global growth, closed borders, and festering tensions around trade, technology, and security have worsened the region's prospects for a trade-led recovery. The IMF said it expects Asia's economy to contract 2.2% in 2021. That decline is 0.6 of a percentage point more significant than its forecast in June 2020 due to sharp slumps in countries like India, the Philippines, and Malaysia. India's economy is likely to shrink 10.3% in 2020 in stark contrast to China, which is set to expand 1.9% as per IMF report. Asia's economy is expected to grow 6.9% in 2021 thanks to the boost from expected more robust recoveries in China, the United States, and the euro area. This example indicates that IMF is helping economies in facilitating trade.

One of the objectives of the IMF is to reduce poverty around the world in which its member countries support as per the requirements. We can consider the example of Japan here to understand it well.

Example: Japan boosts its contribution to IMF's catastrophe relief fund and poverty reduction and growth trust during 2020.

Japan is the largest contributor to IMF financial resources and the most significant contributor to the Fund's concessional lending facilities. Furthermore, Japan is the largest PRGT lender and grant contributor among all IMF member countries. In addition, Japan provided an additional US$100 million contribution to the IMF's Catastrophe Containment and Relief Trust as immediately

available resources to support the Fund's capacity to provide grant-based debt service relief for the poorest and most vulnerable countries to combat COVID-19 in 2020.

The Catastrophe Containment and Relief Trust (**CCRT**) allow the **IMF** to provide grants for debt relief for the poorest and most vulnerable countries hit by catastrophic natural disasters or public health disasters. The Poverty Reduction and Growth Trust allows the International Monetary Fund to provide concessional financial support to low-income countries to help them achieve, maintain, or restore a stable and sustainable macroeconomic position consistent with solid and durable poverty reduction and growth.

These examples reflect how the IMF tries to fulfill its objectives towards the member countries in distress and need support.

The Role of IMF in International Business Operations

The work of IMF is of three main types:

- Surveillance
- Lending
- Technical Assistance

Surveillance involves monitoring economic and financial developments and the provision of policy advice aimed primarily at crisis prevention. A core responsibility of the IMF is to oversee the international monetary system and monitor the economic and financial policies of its 190 member countries, an activity known as surveillance. As part of this process, which takes place at the global, regional, and country levels, the IMF identifies potential risks to stability and recommends appropriate policy adjustments needed to sustain economic growth and promote financial and economic stability.

The IMF also **lends** to countries with balance of payments difficulties, providing temporary financing and supporting policies aimed at correcting the underlying problems; loans to low-income countries are also aimed at poverty reduction.

Third, the IMF provides countries with **technical assistance** and training in their areas of expertise.

Here the question arises: how does the IMF decide the amount of funds to be provided to different economies? And the answer to the same is The IMF Quota.

The IMF Quota

When a country joins the IMF, it contributes a certain sum of money, called a quota, broadly based on its relative size in the global economy. The IMF can draw on this pool of money to lend to countries, and it uses the quota as the basis of how much a country can borrow from the fund. It is also the basis on which the IMF allocates special drawing rights (SDRs). In addition, the Quota determines the voting rights of the individual members. The IMF's largest member is the United States, with a quota (as of April 30, 2016) of SDR 83 billion (about $118 billion), and the smallest member is Tuvalu, with a quota of SDR 2.5 million (about $3.5 million).

Special Drawing Rights:

It is an international reserve asset given to each country to help increase its reserves. It is the unit of account in which the IMF keeps its financial records. (Currencies making up the SDR basket are the U.S. dollar, the euro, the Chinese Yuan, the Japanese yen, and British pound)

An essential responsibility is to monitor and assess vulnerabilities of member countries' economic and financial policies concerning domestic and global stability. Let us understand it with the help of an example.

Example: To address the COVID-19 pandemic issue, The IMF executive board approves US$ 309 Million in emergency assistance to Mozambique.

The IMF approved a disbursement under the Rapid Credit Facility (RCF) of US$309 million to help Mozambique meet the urgent balance of payment and fiscal needs stemming from the COVID-19 pandemic in April 2020. The pandemic is expected to have a significant impact on Mozambique's economy, interrupting a nascent recovery following two powerful tropical cyclones that struck in 2019.

In the above example, we saw how the IMF is trying to help the economies in distress. But there is another viewpoint attached to such international institutions as discussed while covering WTO. Let us extend the same country example (Mozambique) to understand this viewpoint.

Despite the World Bank's commitment to align its activities with the Paris Agreement and the vocal public rhetoric from IMF Managing Director on the need for a "green recovery" to the Covid-19 pandemic, both institutions provided critical support to a controversial new gas mega-project in northern Mozambique in October 2020. Thus, on one side, these international institutions are focusing on sustainable economic growth and, on the other side supporting projects that are harmful to the environment. Let us take another example to have more clarity on the modus operandi of the IMF.

The International Monetary Fund said that it couldn't consider Venezuelan President Nicolas Maduro's request for $5 billion to deal with the corona virus pandemic because the international community doesn't recognize his government. The IMF came up with the statement that said, "unfortunately, the fund is not in a position to consider this request. IMF engagement with member countries is predicated on official government recognition by the international community, as reflected in the IMF's membership. There is no clarity on recognition at this time." Now let us try and understand the issue from the perspective of relations between Venezuela and the IMF.

Venezuela's relationship with the IMF has long been contentious. In 2007, late President Hugo Chavez pledged to cut ties with the fund, considering it a body that serves the interests of the U.S. In 2019, the IMF suspended Maduro's access to almost $400 million of special drawing rights, citing political chaos since opposition leader Juan Guaido was backed by nearly 60 countries as the rightful leader. Such types if instances give rise to the viewpoint that rich countries have considerable power over the lives of billions of people through their control over institutions of global governance. One of these is the International Monetary Fund. As the US and its rich-country allies have a solid majority of the votes. The head of the IMF is custom a European, and the US has enough votes to veto many significant decisions by itself, although the rich countries rarely vote against each other. Let us take another example to understand it better.

Example: The IMF is hurting countries it claims to help (Issue with Ecuador)

Ecuador signed an agreement to borrow $4.2bn from the IMF over three years, provided that the government would adhere to a particular economic program spelled out in the arrangement. The program calls for an enormous tightening of the country's national budget – about 6% of GDP over the next three years. (For comparison, imagine tightening the US federal budget by $1.4 *trillion*, through some combination of cutting spending and raising taxes). In Ecuador, this would include firing tens of thousands of public sector employees, raising taxes that fall disproportionately on poor people, and making cuts to public investment.

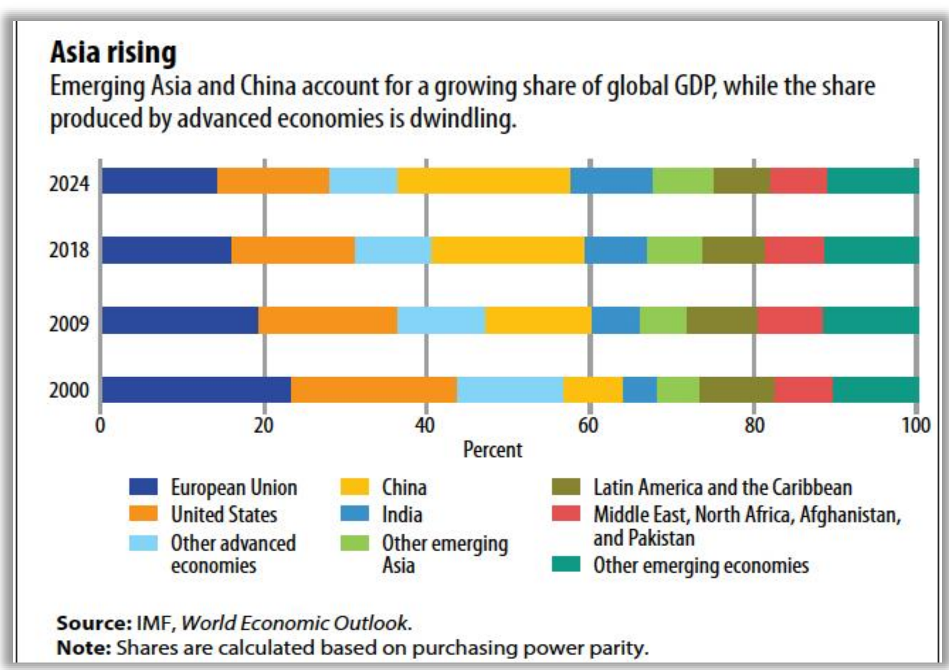
The overall impact of this sizeable fiscal tightening would be to push the economy into recession. The IMF's projections were for a relatively mild recession until 2020, but it would likely be much more profound and more prolonged as often happens with IMF programs. Unemployment will rise even the IMF program projections acknowledged that, and so would poverty.

It would likely turn out much worse than the IMF projects because the program relies on assumptions that were not believable. For example, the IMF projects that there would be a net foreign private-sector inflow into the economy of $5.4bn (about 5% of GDP) for 2019–2022. Yet, if we look at the last three years, since 2016, there was an outflow of $16.5bn (17% of GDP). What would make foreign investors suddenly so much more excited about bringing their money to Ecuador? Certainly not the recession that even the IMF is projecting. All such instances create an image of international institutions like IMF, a bit dubious. It appears to some nations as if these institutions are working for few developed countries only. This kind of perception needs to be changed by the IMF.

The IMF Future Outlook

The world is changing. The IMF is changing with it. The question, however, is not only how it needs to change if it is to remain relevant. It is also whether the political environment will allow it to stay relevant. The IMF is built on a commitment to cooperation among member countries. That commitment is on the wane. But the nations of the world might rediscover its importance. If so, they will find the Fund an invaluable instrument. The IMF cannot ensure that outcome. But it can, and must, prepare for it. To its credit, it is doing so. The world surrounding the International Monetary Fund has changed or is changing in several crucial respects.

The first and most significant change is a shift in global economic, and therefore political, power. In 2000, advanced economies generated 57 percent of global output, measured by purchasing power parity. By 2024, according to IMF forecasts, that share will fall to 37 percent. Meanwhile, China's share will jump to 21 percent from 7 percent. The rest of emerging Asia will account for 39 percent of global output, compared with 14 percent for the United States and 15 percent for the European Union.



The second transformation increases great-power rivalry as relations deteriorate between Western powers and a rising China. The United States has labeled China a "strategic competitor." The European Union, more narrowly, has called it an "economic competitor in the pursuit of technological leadership." Either way, cooperation seems sure to become more complex.

The third change is a turn toward populist politics, not least within advanced economies. One feature of this populism is suspicion toward technocratic expertise. This affects not just the credibility of domestic technocratic institutions, including independent central banks and finance ministries, but also international technocratic institutions. The IMF is arguably the most significant.

The fourth change consists of the slowdown, or even reversal, of globalization. This type of change is markedly actual in some areas of finance, such as a dramatic decline in the foreign claims of euro area banks. Recently we have even seen the emergence of outright protectionism in the United States.

The last change is the rising salience of climate change as a policy issue. This type of change is likely to significantly affect development strategies and macroeconomic policies in all countries, particularly in poorer and more vulnerable ones.

All this creates a highly challenging environment for the IMF, which has also been changing. Indeed, its most durable characteristic has been its ability to adapt to successive changes in the world. This partly reflects the high quality of its staff and its usually competent management.

Before we proceed with the following topic, let us understand what we mean by foreign exchange.

Foreign exchange is money denominated in the currency of another nation or group of countries.

7.2 Foreign Exchange Market

It is an over-the-counter (OTC) global marketplace that determines the exchange rate for currencies worldwide. Participants can buy, sell, exchange, and speculate on currencies. For multinational companies to conduct business, foreign exchange is one of the critical factors in the environment—for example, a U.S.-based company doing business with a company in Japan and paying them in U.S. currency. Foreign exchange can be in the form of cash, funds available on credit and debit cards, traveler's checks, bank deposits, or other short claims.

Exchange Rate is the price of a currency specifically, the number of units of one currency that buy one unit of another currency. The number can change daily. Example: On January 8, 2021, 1$ could purchase INR 73.33.

The Bank for International Settlements (BIS), a financial organization centered in Basel, Switzerland, owned and controlled by 60 member central banks, divides the market into three major categories:

Reporting Dealers

Also known as money center banks, large financial institutions actively participate in local and global foreign exchange and derivate markets. They are widely assumed to include the largest banks and financial institutions in terms of overall market share in foreign-exchange trading, such as Deutsche Bank, Citi Bank, HSBC, JP Morgan, etc.

Financial Institutions

Other Financial Institutions are not classified as reporting dealers. They include smaller local and regional commercial banks, investment banks and securities houses, hedge funds, pension funds, money market funds, currency funds, mutual funds, specialized foreign-exchange trading companies, and so forth.

Nonfinancial Institutions

Nonfinancial Institutions like Western Union is a nonbanking financial institution that deals in foreign exchange.

Another term that is important to understand the functioning of international financial markets is Bank for International Settlement.

Bank for International Settlement

The BIS is a global center for financial and economic interests. As such, it has been a principal architect in the development of the global financial market. Moreover, given the dynamic nature of social, political, and economic situations worldwide, the BIS can be seen as a stabilizing force, encouraging financial stability and international prosperity in the face of global change.

Let us now look at the ways of doing a foreign exchange in international markets.

Ways of Doing Foreign Exchange

Dealers can trade foreign exchange:

- Directly with customers,
- Through voice brokers,
- Through electronic brokerage systems,
- Directly through interbank.

The foreign exchange market has two major segments:

- ***The over-the-counter market (OTC)*** comprises commercial banks as just described, investment banks, and other financial institutions.
- ***The exchange market (Securities Exchanges)*** comprises securities exchanges, such as the CME Group, NASDAQ OMX, and Intercontinental Exchange (ICE), where certain foreign-exchange instruments, such as futures and options, are traded.

Global Over-the-counter market foreign exchange instruments are:

- Spot transactions
- Outright forward transaction
- FX swap
- Currency swaps
- Options

Spot transactions

It involves the exchange of currency for delivery in two business days after the day the transaction was made. For example, A bank would quote an exchange rate for a Monday, but delivery would take place on Thursday. The rate at which the transaction is settled is the spot rate.

Outright forward transaction

It involves the exchange of currency on a future date beyond two business days. It is the single purchase or sale of a currency for future delivery.

FX swap

One currency is traded for another on one date and then swapped back later. The first or short leg of an FX swap is often a spot transaction, and the second or long leg a forward transaction. Thus, an FX swap is a simultaneous spot and forward transaction.

IBM receives a dividend in British pounds from its subsidiary in the United Kingdom but has no use for British pounds until it has to pay a UK supplier in 30 days. It would rather have dollars now than hold on to the pounds for a month. IBM could enter into an FX swap in which it sells the pounds for dollars to a dealer in the spot market at the spot rate and agrees to buy pounds for dollars from the dealer in 30 days at the forward rate.

Currency Swaps

It deals with interest-bearing financial instruments such as bonds and involves the exchange of principal and interest payments.

Similarly, hedging is a way for a company to minimize or eliminate foreign exchange risk. Two common hedges are forward contracts and options. A forward contract will lock in an exchange rate today at which the currency transaction will occur at a future date.

Options

A currency option (also known as a forex option): is a contract that gives the buyer the right, but not the obligation, to buy or sell a particular currency at a specified exchange rate on or before a specified date. For this right, a premium is paid to the seller.

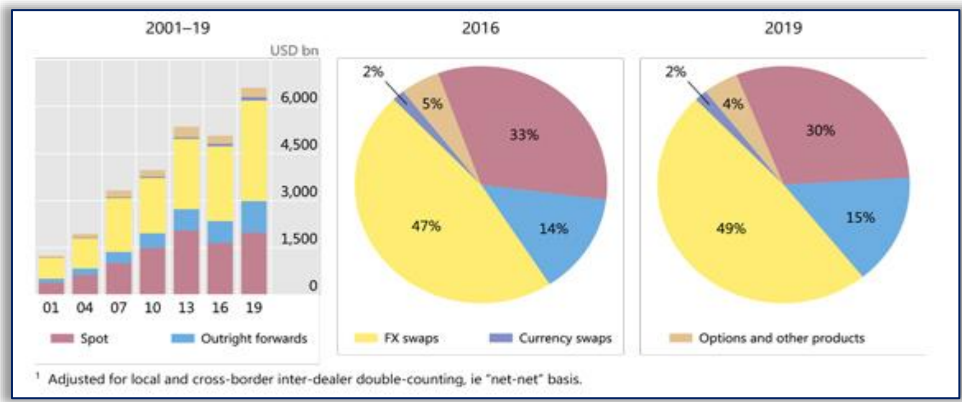
Similarly, a future contract is an agreement between two parties to buy or sell a particular currency at a specific price on a particular date, as specified in a standardized contract to all participants in a currency future exchange rather than in the over-the-counter market.

Let us understand the working of these instruments with the help of an example.

Example: Indian firms getting impacted due to increase in hedging cost

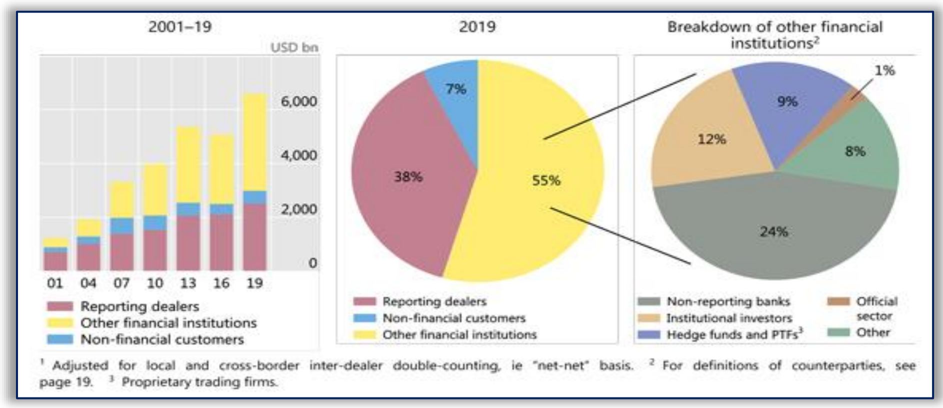
Indian companies have paid the most from May 2020 till December 2020 to hedge dollar borrowings, adding to strains at firms already stretched by the pandemic. The six-month Mifor swap rate, a derivative that firms use to hedge against moves in rates with foreign-currency borrowings, has climbed eight basis points in December 2020 to 4.6%. Indian companies that borrow in overseas markets were already struggling due to weaker earnings because of the pandemic. A decline in the rupee against the dollar in 2020 has also pushed up their foreign debt-servicing costs. The rupee weakened the most of any primary Asian currency against the dollar so far in 2020, losing about 2.9%.

Contribution of Various Foreign Exchange Instruments



We can see from the above chart that in the last two decades, FX Swaps is one of the widely used foreign exchange instrument across the globe, followed by Spot and Outright forwards.

Statistics of foreign exchange as per major players



We can see from the chart above that other financial institutions have contributed the maximum in the foreign exchange trades compared to Reporting dealers and Nonfinancial customers. In Other financial institutions, Non-reporting banks have contributed the most in foreign exchange trades, followed by Institutional investors and hedge funds.

Let us take an example of a central bank of an economy and see how they utilize these instruments.

Example: Reserve Bank of India signed a $400 million currency swap pact with the Central Bank of Sri-Lanka in July 2020.

The SAARC currency swap framework came into operation on November 15, 2012, to provide a backstop line of funding for short-term foreign exchange liquidity requirements or short-term balance of payments stress till longer-term arrangements are made. The Central Bank of Sri Lanka can make drawals of US Dollar, Euro, or Indian Rupees in multiple tranches up to a maximum of USD 400 million or its equivalent under a currency swap agreement. In November 2019, the RBI, with the concurrence of the Government of India, had decided to put in place a revised framework on currency swap arrangement for SAARC countries 2019-2022 to further financial stability and economic cooperation within the SAARC region.

The framework is valid from November 14, 2019, to November 13, 2022. Based on the terms and conditions of the framework, the RBI would enter into bilateral swap agreements with SAARC central banks, which want to avail the facility. The above example illustrates how government institutions make use of foreign exchange instruments.

Now let us focus on foreign exchange markets around the globe. The biggest geographic trading center is the United Kingdom, primarily London. In April 2019, trading in the United Kingdom accounted for 43.1% of the total, making it by far the most important center for foreign exchange trading globally. However, the widely traded currency in the world is the US dollar.

Important reasons for U.S. dollar being so widely traded:

- It's an investment currency in many capital markets.

- It's a reserve currency held by many central banks.
- It's a transaction currency in many international commodity markets.
- It's an invoice currency in many contracts.
- It's an intervention currency employed by monetary authorities in market operations to influence their exchange rates.

Major Foreign Exchange markets

- The Spot Market
- The Forward Market
- Options
- Futures

The Spot Market:

Rates are quoted by foreign exchange dealers. The bid (buy) rate is the price at which the dealer is willing to buy the foreign currency; the offer (sell) is the price at which the dealer will sell foreign currency. The difference between the bid and offer rates is the dealer's profit margin.

The Forward Market

The forward rate is the rate quoted for transactions that call delivery after two business days. A forward discount exists when the forward rate is weaker than the spot rate. Conversely, a premium exists when the forward rate is stronger than the spot rate.

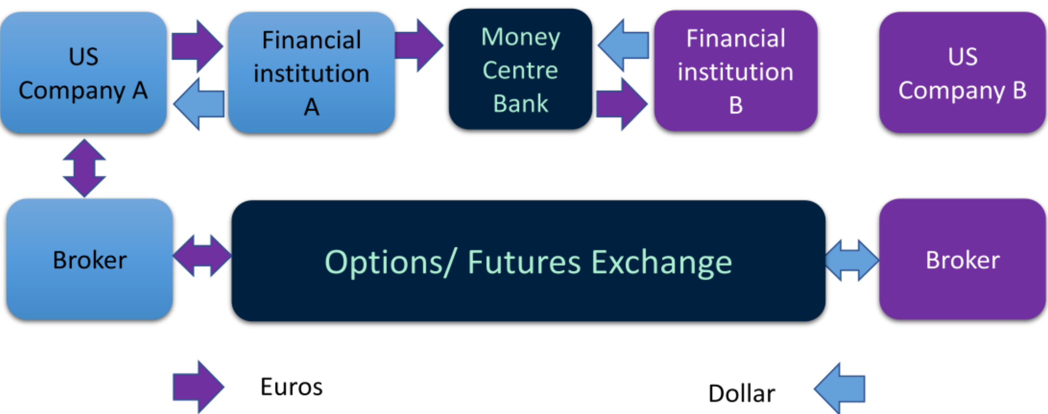
Options

An option is a right, but not the obligation, to trade a foreign currency at a specific exchange rate.

Futures

A futures contract specifies an exchange rate in advance of the actual exchange of currency, but it is not as flexible as a forward contract.

The Foreign-Exchange Trading Process



When a company sells goods or services to a foreign customer and receives foreign currency, it needs to convert it into domestic currency. When importing, the company needs to convert domestic to foreign currency to pay the foreign supplier. This foreign exchange trading process shows what happens when US company A needs to sell Euros for dollars. This situation could arise when A receives payment in Euros from a German importer. The right side of the figure shows what happens when B needs to buy Euros with dollars which could occur when a company has to pay Euros to a German supplier. In either case, the US Company would contact its bank for help in converting the currency. If it's a large company, let's say a fortune 500, it will directly deal with a money center bank as shown on the top arrow and not worry about other financial institutions.

Smaller companies would probably work through financial institutions A or B. Assume US company B is going to receive Euros in the future, because it cannot convert in the spot market until it receives the Euros, it can consider a forward, swap, options, or futures contract to protect itself until the currency is finally delivered. The financial institutions can make a forward, swap, or

options contract for company B. The above example explains how the foreign-exchange trading process takes place.

The IMF surveillance and consultation programs are designed to monitor countries' exchange-rate policies and see if they are acting openly and responsibly in exchange-rate policies. The IMF requires countries to identify how they base their exchange-rate policy. IMF permitted countries to select and maintain an exchange-rate arrangement of their choice, provided they communicated their decision to the IMF. The IMF classifies currencies into one of three broad categories, moving from the least to the most flexible. It leads to exchange-rate determinants.

7.3 Exchange-Rate Determinants

These are:

- Hard Peg
- Soft Peg
- Floating Arrangement

Hard Peg:

A hard peg exchange rate is where one country's currency is tied to a usually stronger currency, such as the euro or US dollar. There are two possibilities for countries that adopt a hard peg. The first, called dollarization, can occur when a country like Zimbabwe or Ecuador does not have its currency but has adopted the US dollar as its currency.

The second example of the hard peg is a currency board, separate from a country's central bank. It is responsible for issuing domestic currency, typically anchored to a foreign currency. If it does not have deposits on hand in the foreign currency, it cannot issue more domestic currency. Again, Hong Kong is a good example. Even though the HK dollar is locked onto the US dollar, it moves up and down against other currencies since the US dollar is a freely floating currency. Let us consider the example of Hong Kong to understand this well.

Example: Unrest situation in Hong Kong in 2019-20.

For the past 37 years, the city has run a managed peg, tying the Hong Kong currency to the US dollar. In 2019-20, the greenback traded in a narrow band between HK$7.75-7.85. And given that the currencies were pegged, one should expect differences in market interest rates to be marginal. But it was this spread between US and Hong Kong market interest rates that incentivized traders to hold one currency relative to the other. If there were a demand for the Hong Kong dollar, the currency would test the firm boundary of its tradable range. If that happens, the Hong Kong Monetary Authority steps in and printed as many new Hong Kong dollars as it thinks necessary to depressed the interest rate.

From 2009 to 2017, strong demand for HKD saw interest rates consistently low, relative to the US. But in 2018, this all changed. The Hong Kong dollar made its way through the tradable band and eventually hit HK$7.85 in 2019. This prompted the monetary authorities to sell US dollars and take excess HKD from the market.

The political crisis looked intractable. What began in May 2019 as a relatively peaceful protest to perceived draconian legislation has deteriorated into a chaotic siege of unrest. Moody's announced a credit-rating downgrade saying the government's response to the troubles had been "notably slow, tentative and inconclusive." Policymakers faced a Gordian knot. The Beijing-backed government and the protesters both appeared unwilling to compromise. Few in Hong Kong believed that either side would back down.

Thus, pressure on the currency saw rates rising higher and faster than a Wan Chai construction project. And if rates did rise to intolerable levels, policymakers faced three choices, each as unpalatable as the next. The first was to impose capital controls to restrict US dollar outflows. However, that could undermine the city's status as a financial centre and be difficult to impose, given its open history. A second option was to break the currency board system by releasing more Hong Kong dollar liquidity. That means selling US dollars to the market without buying up excess HKD, circumventing the mechanism that allows rates to rise to create a balance.

But by doing that, policymakers would have to acknowledge that rates were being suppressed, which could encourage both locals and speculators to convert as many USD to HKD as they could.

That would burn through reserves without having higher rates to incentivize more currency holding, which would get buyers to return.

The third option was to reset the peg at a weaker level. This scenario would keep rates sustainably in policymakers' comfort zone. Now, this would be decided by policymakers which path would be ideal for them. The example mentioned above showcased how exchange rate determinants like hard peg work for different economies.

Soft Peg

It describes the exchange rate regime applied to a currency to keep its value stable against a reserve currency or a basket of currencies. Currencies with a soft peg are halfway between those with a fixed or hard pegged exchange rate and those with a floating exchange rate.

The main difference between soft and hard pegged currencies is that the soft peg systems provide limited monetary policy flexibility to allow governments and central banks to deal with economic shocks. A soft peg can be applied to the reserve currency within a narrow or a wide range. The range is usually modified over time, depending on international inflation rates. An example of the same can be Zimbabwe's economic crisis. The soft peg on currency acts as a deterrent to export growth (since 30% of foreign receipts are settled using a pegged rate) while encouraging consumption of finished merchandise by giving cheap foreign currency to importers.

The imbalance can only be resolved through a managed floating exchange rate where commercial banks act as matchmakers between importers and exporters with an efficient foreign exchange rate. Of course, the exchange rate may be volatile in the short term. Still, it will save the central bank from continuously printing money (managing inflation) and redirect foreign currency circulating in the informal sector to the formal economy. The exchange rate spread also discourages gold mining production from primary producers who retain only 70% of the earnings when small-scale and artisanal miners get 100% in foreign currency. This deters production while providing loopholes for smuggling and diversion of gold to small-scale miners for onward side marketing. We can see another example here from Switzerland.

Example: Swiss franc soared as Switzerland abandoned the Euro cap in January 2015.

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The Swiss National Bank (SNB) took the step to remove the cap, introduced in September 2011, as it was no longer justified. Many investors believe that with the franc so strong Swiss companies would struggle to maintain export levels. This has even been discussed in unit one when we talked about the Swiss Watch industry.

Floating Arrangement

A floating exchange rate is one that is determined by supply and demand on the open market. Free-floating currencies are subject to intervention only in exceptional circumstances. The major trading currencies, including the US dollar, the Japanese yen, the British pound, and the euro, are freely floating currencies. In addition, Brazil and India, two of the BRIC countries, are considered to have floating currencies.

A floating exchange rate doesn't mean countries don't try to intervene and manipulate their currency's price since governments and central banks regularly attempt to keep their currency price favorable for international trade.

Example: The Pound and the Euro

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Over the years, there have been official attempts to wind down the pound's international role, with solemn references to "the sterling balances," the official holdings of the UK currency by foreign governments. But somehow, it never quite happens. The pound remains one of five reserve currencies used by the International Monetary Fund (IMF) to underpin its denomination, the Special Drawing Right.

The euro, by contrast, is a significant currency sitting on a large economy, circulating in 19 of the European Union's member-states. When Britain was an EU member, it declined to join, exercising the opt-out negotiated in the 1992 Maastricht Treaty. As a result, both float freely, and so the relative value of the two denominations is decided by market forces rather than official intervention.

When the euro was launched in January 1999, there were fears that the sterling would be trapped in the crossfire between the dollar and the single currency. But that did not happen to any great extent, and during the past year, the pound has strengthened against the dollar. Now here we would like to emphasize that EU has introduced a common currency to its already existing internal free trade agreement and common external tariff policy.

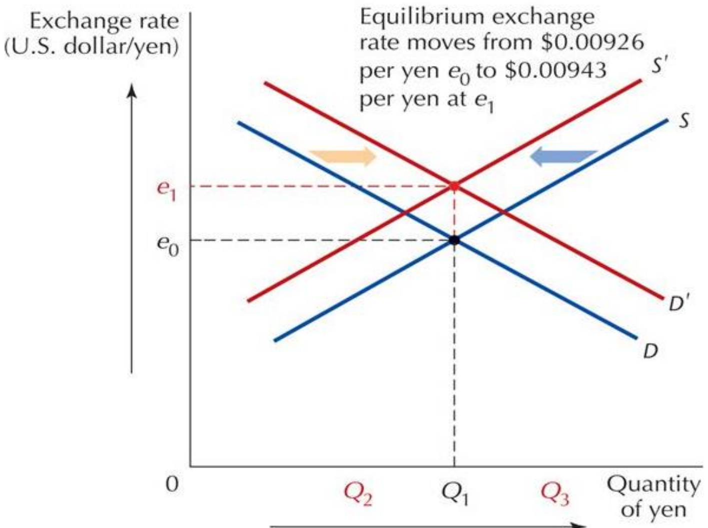
According to the Treaty of Maastricht, countries had to meet certain criteria to comply with the exchange rate mechanism and be a part of the European Monetary Union (EMU). The criteria outlined in the treaty are:

- The annual government deficit must not exceed 3% of GDP.
- Total outstanding government debt must not exceed 60% of GDP,
- The rate of inflation must remain within 1.5% of the three best-performing EU countries,
- The average nominal long term interest rate must be within 2% of the average rate in the three countries with the lowest inflation rates,
- Exchange-rate stability must be maintained, meaning that the country concerned has kept within the normal fluctuation margins of the European Exchange Rate Mechanism for at least two years.

Determining Exchange Rates

It can be done in two ways:

- Non-intervention (Currency in a floating-rate world)
- Intervention (Currency in a fixed-rate or managed floating-rate world)



The Equilibrium Exchange Rate

The equilibrium exchange rate can be illustrated using a two-country model involving the United States and Japan. This graph shows the equilibrium exchange rate in the market and then a movement to a new equilibrium level as the market changes.

Assume that Japanese consumer's demand for US goods and services drops because of saying high US inflation. This lessening demand would result in a reduced supply of yen in the foreign exchange market, causing the supply curve to shift to S'. However, simultaneously the rising prices of US goods might lead to an increase in American consumers demand for Japanese goods and services, which in turn would lead to a rise in demand for yen in the market, causing the demand curve to shift to D' and finally to an increase in the quantity of yen and exchange rate. This states the non-intervention.

In the preceding example, Japanese and US authorities allowed supply and demand to determine the values of the yen and dollar. However, assume that the United States and Japan decide to manage their exchange rate. Although both currencies are independently floating, their respective government could intervene in the market. For example, the US government might not want its

currency to weaken because its companies and consumers would have to pay more for Japanese products, which would lead to more inflationary pressure in the US. Thus, this example reflects the

Let us take a real-life example to understand this concept.

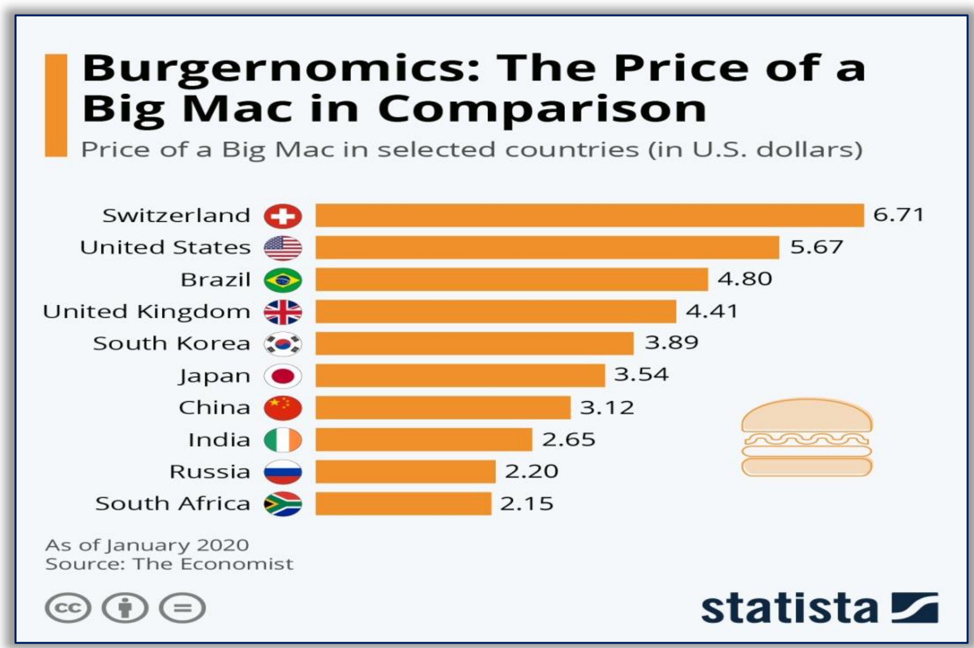
Example: Reserve Bank of India may ease up on currency intervention, protecting reserves during the pandemic in April 2020.

The RBI mainly had been on the buy-side of the trade, having amassed $476 billion of reserves to provide about 12 months of import cover. Such measures help the economy to prosper in the right direction.

Exchange Rates & Purchasing Power Parity

The PPP exchange rate is the rate at which one country's currency would have to be converted into that of another country to buy the same goods and services in each country. Therefore, examining the difference between the PPP exchange rate and the market exchange rate helps us understand how trade relations might be affected.

The Big Mac Index



As we can see from the table, most currencies were undervalued against the dollar, so it is harder for US companies to export during this period of the strong dollar. Conversely, it is easier for companies outside of the United States to export to the United States. However, these relationships change as the dollar weakens against other currencies. The value of the Big Mac index is in understanding that price differences are not sustainable in the long run. The exchange rate will eventually have to equalize price differences more closely, or the law of supply-demand will take over. Now that brings us to the end of this unit.

Self-Assessment

1. The primary objective of the International Monetary Fund is to ________.
   A. encourage euro adoption
   B. promote exchange rate stability
   C. establish a unilateral system of payments
   D. foster the power of the foreign-exchange market

2. The Bretton Woods Agreement established a system of fixed exchange rates under which each IMF member country set a ________.
   A. quota
   B. par value
   C. gold standard

D. nominal interest rate

3. To join the IMF, a country must contribute a certain sum of money, called a ________.
   A. special drawing right
   B. trade balance
   C. monetary reserve
   D. quota

4. Which of the following BEST describes the special drawing right?
   A. an international reserve asset created to supplement members' existing reserve assets
   B. the official currency for international trade established by the World Bank
   C. a substitute for the fixed value of gold as determined by currency rates
   D. a contribution made by countries to join the IMF
   A. True
   B. False

5. The IMF's primary role is to identify exchange rate regimes.
   A. True
   B. False

6. The IMF uses the quota system to determine how much a country may borrow from the Fund.
   A. True
   B. False

7. Which type of exchange rate arrangement is based on supply and demand?
   A. soft peg
   B. hard peg
   C. crawling
   D. floating

8. All of the following are ways to control currency convertibility EXCEPT ________.
   A. import licenses
   B. multiple exchange rates
   C. import deposits
   D. purchasing power parity

9. If inflation in the United States is relatively higher than inflation in Japan, and the Japanese government wants to keep the exchange rate fixed between the yen and the dollar, it should most likely ________.
   A. allow its currency to rise against the dollar
   B. allow its currency to fall against the dollar
   C. increase the supply of yen in the market
   D. decrease the supply of yen in the market

10. The ________ is the currency most widely used as a reserve asset.
   A. euro
   B. Japanese yen
   C. U.S. dollar
   D. British pound

11. The Fed wants to counter downward pressure on the dollar, so it will most likely ________.
   A. sell dollars for foreign currency
   B. sell dollars and buy foreign stocks
   C. buy Treasury bills with dollars
   D. buy dollars with foreign currency

12. Hard currencies are usually ________.

A. not fully convertible
B. undesirable assets
C. highly liquid
D. unstable

13. The purchasing power parity theory claims that a change in relative ________ between two countries must cause a change in ________ to keep the prices of goods in two countries fairly similar.
A. exchange rates; inflation
B. inflation; exchange rates
C. interest rates; inflation
D. interest rates; exchange rates

14. Which of the following statements BEST describes a limitation of the Big Mac Index?
A. Profit margins vary by the strength of competition, which affects relative prices.
B. The theory of PPP incorrectly assumes that there are trade barriers.
C. The Big Mac represents all possible commodities and services.
D. Taxes do not affect Big Mac prices.

15. If a Big Mac costs $3.41 in the United States and $2.67 in Argentina (the price of a Big Mac in Argentine pesos converted into dollars at the spot exchange rate), which of the following is most likely true?
A. The peso is overvalued against the dollar.
B. The dollar is overvalued against the peso.
C. It should be more challenging for a U.S. tourist to buy a leather coat in Buenos Aires because the dollar won't go very far.
D. It will be cheap for Argentine companies to invest in the United States because the dollar is relatively weak.

Answers for Self Assessment

1. B	2. B	3. D	4. A	5. B
6. A	7. D	8. D	9. C	10. C
11. D	12. C	13. B	14. A	15. B

Summary

International Monetary Fund 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 worldwide.

The work of IMF is of three main types: surveillance, lending, and technical assistance.

When a country joins the IMF, it contributes a certain sum of money, called a quota, broadly based on its relative size in the global economy. The IMF can draw on this pool of money to lend to countries, and it uses the quota as the basis of how much a country can borrow from the fund.

It is an over-the-counter (OTC) global marketplace that determines the exchange rate for currencies worldwide.

The BIS is a global center for financial and economic interests. As such, it has been a principal architect in the development of the global financial market. Moreover, given the dynamic nature of social, political, and economic situations worldwide, the BIS can be seen as a stabilizing force, encouraging financial stability and international prosperity in the face of global change.

The IMF classifies currencies into one of three broad categories, moving from the least to the most flexible known as exchange rate determinants, hard peg, soft peg, and floating arrangements.

The PPP exchange rate is the rate at which one country's currency would have to be converted into that of another country to buy the same goods and services in each country.

Keywords

Surveillance: It involves monitoring economic and financial developments and providing policy advice, aimed especially at crisis prevention.

Special Drawing Rights: It is an international reserve asset given to each country to help increase its reserves. It is the unit of account in which the IMF keeps its financial records.

Reporting Dealer: also known as money center banks, large financial institutions actively participate in local and global foreign exchange and derivate markets.

Spot Transaction: It involves exchanging currency for delivery in two business days after the day the transaction was made.

Outright Forward Transaction: It involves the exchange of currency on a future date beyond two business days. It is the single purchase or sale of a currency for future delivery.

Currency Swaps: It deals with interest-bearing financial instruments such as bonds and involves exchanging principal and interest payments.

Purchasing Power Parity is the rate at which one country's currency would have to be converted into that of another country to buy the same goods and services in each country.

Options: A currency option (also known as a forex option): is a contract that gives the buyer the right, but not the obligation, to buy or sell a particular currency at a specified exchange rate on or before a specified date. For this right, a premium is paid to the seller.

Review Questions

1. What is the International Monetary Fund (IMF)? What are its objectives? What occurs when a country joins the IMF today?

2. What is a Special Drawing Right (SDR)? How is it used?

3. What is the Bank for International Settlements? What three categories does the BIS designate in the foreign-exchange market? Briefly describe each category.

4. What are the two major segments of the foreign exchange market? What types of foreign exchange instruments are traded within these markets?

5. How is foreign exchange traded? What methods are available?

6. What is a futures contract? What institutions handle futures contracts?

7. What are the characteristics of the forward market? Why do companies participate in the forward market? Provide an example to illustrate your answer.

8. In a short essay, discuss purchasing power parity and the short-run problems that affect PPP.

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UNIT 8: Global Debt and Equity Market

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Objectives

After studying this unit, you should be able to

- appraise the different ways to access debt internationally.
- analyze how offshore financial centers provide financing opportunities for MNEs.
- demonstrate the functioning of the equity market.
- illustrate the role of banking and non-banking financial services.

Introduction

Debt market and equity market are broad terms for two categories of investment that are bought and sold. The debt market, or bond market, is the arena in which investments in loans are bought and sold. There is no single physical exchange for bonds. Instead, transactions are mostly made between brokers or large institutions or by individual investors. The equity market, or the stock market, is the arena in which stocks are bought and sold. The term encompasses all marketplaces such as the New York Stock Exchange (NYSE), the NASDAQ, the London Stock Exchange (LSE), and many others.

Investments in debt securities typically involve less risk than equity investments and offer a lower potential return on investment. Debt investments by nature fluctuate less in price than stocks. Even if a company is liquidated, bondholders are the first to be paid. Equity, or stock, represents a share of ownership of a company. The owner of an equity stake may profit from dividends. Dividends are the percentage of company profits returned to shareholders. The equity holder may also profit from the sale of the stock if the market price should increase in the marketplace.

8.1 The Finance Function

The Corporate finance function acquires and allocates financial resources among the company's activities. The role of financial management is to maintain and create economic value or wealth by maximizing shareholder wealth.

The key functions are:

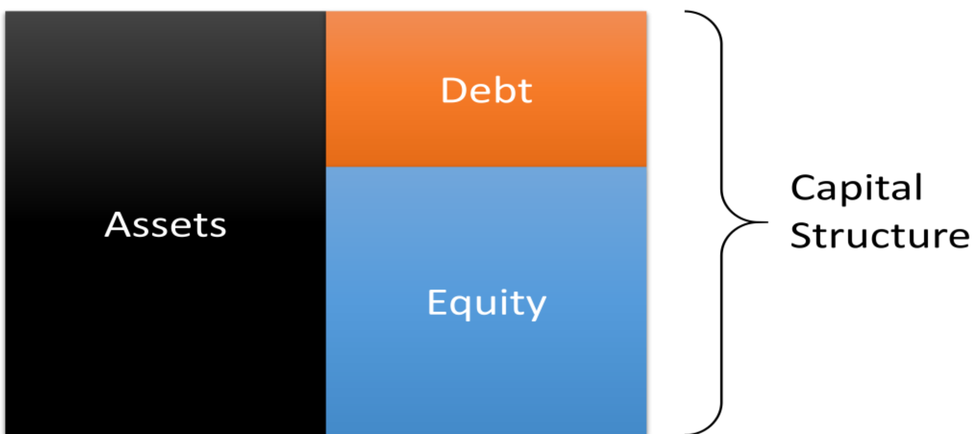
- Making financing decisions, especially regarding capital structure, includes the proper mix of debt and equity and long-term financing.

- Making investment decisions, typically in the context of capital budgeting
- Managing short-term capital needs: it covers managing the MNE currency assets and liabilities.

Capital Structure

Capital structure is how a company funds its overall operations and growth. Debt consists of borrowed money that is due back to the lender, commonly with interest expense. Equity consists of ownership rights in the company, without the need to pay back any investment.

It is the particular combination of debt and equity used by a company to finance its overall operations and growth. Debt comes in the form of bond issues or loans, while equity may come in the form of common stock, preferred stock, or retained earnings. Short-term debt is also considered to be part of the capital structure.



Leverage

The degree to which a firm funds the growth of the business by debt is known as leverage. Leveraging is not always the best approach in all countries for two major reasons. First excessive reliance on long-term debt raises financial risk and thus requires a higher return for investors. Second, two foreign subsidiaries of an MNE may have limited access to local capital markets, making it difficult for the MNE to rely on debt to fund asset acquisition.

Let us take an example to understand the role of the capital structure in an organization.

IL&FS crisis of Indian debt market

The Indian debt market has had a tough ride for a few years in recent times. The slowdown in the domestic economy and the liquidity crisis following the IL&FS fiasco had bruised the debt market sufficiently in the pre-Covid months. And then, the lockdown and other restrictions following the outbreak of the pandemic only accentuated the situation.

Liquidity crunch and risk aversion have been major issues plaguing the financial sector for some time now. In the current scenario, there is a tendency among investors to dump risky assets and turn to safe havens amid an uncertain economic outlook. This has, in turn, led to increased redemption pressure in the debt market that fuelled the liquidity crunch. While RBI has announced various measures to ensure liquidity in the market, its effectiveness seems limited.

The economic slowdown and risk aversion made it difficult for bond issuers to raise money from the debt market. The NBFC sector was the worst affected, as they mainly rely on the issuance of commercial papers to meet credit requirements. However, the IL&FS episode restricted NBFCs borrowing from the debt market, as mutual funds limited their exposure to NBFC securities.

Consequently, several sectors such as real estate faced massive liquidity crunch, as they relied mainly on NBFCs for funds. It needs to be highlighted that the collapse of IL&FS was linked to a structural issue in the economy. It resulted from a delay in the commencement of various projects due to issues involving land acquisition. And that crisis played a major role in creating risk-aversion, which resulted in the debt market crisis. These developments underline that more measures were needed to strengthen the corporate bond market in India in 2020. However, despite various initiatives, the performance of the debt market has not been up to the expected level. Issues such as the high cost of borrowing and inadequate liquidity continue to dog this segment.

It demanded more measures from the regulators as a healthy and robust debt market was essential to meet business and industry credit requirements in a growing economy. With the help of the above example, we have seen how important it is for regulators and policymakers to make sure that debt markets remain in a stable state for better functioning of the economy.

Factors Affecting the Choice of Capital Structure

These are:

- Tax Rates,
- Degree of development of local equity markets,
- Creditor rights.

Where tax differences are critical, firms tend to use more debt since they can deduct interest expense and lower their tax liability. MNE tend to use debt in countries with relatively high tax rates and a high degree of corruption.

Let us take a small case-let of Iceland's economic crisis to understand the global debt and equity market well.

Iceland Economic crisis

Banks in ruins, a currency in free fall, and the IMF called to the rescue: A decade ago, Iceland's worst financial crisis erupted, a traumatic experience the nation still struggles to forget. Once dependent on fisheries, the Arctic island was in 2008 a country of flashy bankers with a vibrant finance sector, where locals enjoyed the highest standard of living in the world.

Just before the crisis, the assets of the country's three biggest banks, namely Kaupthing, Landsbanki, and Glitnir, totalled more than ten times the gross domestic product (GDP) of the small volcanic island. The trio was pushing loans aggressively with attractive interest rates, both at home and abroad. In a nation of around 320,000 people, some 70,000 families had taken bank loans, often indebting themselves up to their ears to treat themselves to a nice 4x4 or a spacious new home.

But on September 15, 2008, U.S. investment bank Lehman Brothers filed for bankruptcy, and instantly, the global credit market froze up. For Iceland's three biggest banks, which had funded their breakneck international expansion with astronomical loans and which now had no access to refinancing, it was a disaster. There was a genuine danger that the Icelandic economy, in the worst case, could be sucked with the banks into the whirlpool, and the result could be national bankruptcy.

The Icelandic currency lost more than half its value in just a few months, and inflation rose to 18 percent. As the country teetered on the verge of bankruptcy, the government introduced capital controls, urgently took control of the three banks, and put in a call to the International Monetary Fund (IMF). As a result, Iceland became the first Western country to receive a bailout from the IMF since Britain in 1976, securing a $2.1 billion package in October 2008. This example shows that if debt markets are not controlled effectively that this could lead to financial disasters.

After knowing the importance of managing debt markets, we can now proceed to an important topic of this unit.

8.2 International Debt Markets

According to the Bank for International Settlements, the international debt market involves the buying and selling corporate and government bonds issued by non-residents of the local debt market. In other words, an international debt market is a bond market where only foreign bonds are traded. Let us understand it with the help of an example.

High yield debt market momentum to continue in Europe in 2021.

An uptick in M&A activity, alongside an economic recovery, as well as fiscal and monetary stimulus, would keep the European sub-investment grade market running hot in 2021. The European Central Bank's and the Bank of England's bond-buying programs pushed investment-grade investors into buying riskier paper. While that trend may continue for the short term, monetary and fiscal support won't last indefinitely. And this needs to be taken care of if markets want to cool the yields a bit. This concept can have a better understanding with the help of Eurocurrency and Eurocurrency markets.

Eurocurrencies & the Eurocurrency Market

A Eurocurrency is any currency banked outside its currency of origin. The Eurocurrency market is an important source of debt financing to complement what multinational enterprises can find in their domestic market.

Major sources of Eurocurrency are:

- Foreign governments or individuals who want to hold dollars outside the United States.
- Multinational enterprises that have cash in excess of current needs.
- Banks with foreign currency in excess of current needs
- Countries such as China, which have large foreign exchange reserves.

As Eurocurrency market is a wholesale rather than a retail market, transactions are huge. Public borrowers such as governments, central banks, and public sector corporations are the major players. The Eurodollar market is the most significant Eurocurrency market. And Euro dollar is a certificate of deposit in U.S. dollars in a bank outside the United States. Let us take an example to understand the major source of Eurocurrency.

India's forex reserve in 2020

When the economy was under stress due to the corona virus pandemic, India's foreign exchange (forex) reserves have been rising at a breakneck pace. They touched a new high in December 2020. The country's foreign exchange reserves rose by $2.56 billion in the week ended December 18 to hit fresh all-time high of $581.131 billion, making it the fifth-largest holder of reserves in the world. This is an example of the major source of the Eurocurrency market.

International bonds

An international bond is a debt obligation issued in a country by a non-domestic entity in its native currency. International bonds are usually corporate bonds. International bonds can offer portfolio diversification but are highly subject to currency risk. We can consider the Indian economy debt market in late 2020 as it moved towards the growth path.

The beginning of the financial year 2020-21 saw a sharp risk aversion to corporate bonds that was reflected in the widening of credit spreads on the back of demand for a moratorium on servicing of bonds similar to bank loans, resulting in uncertainty on underlying asset quality. In addition, a

mutual fund house's winding-up of few debt schemes meant that the debt capital market was heading for tough times over the next few months in FY21.

However, positives like the improvement in economic activities post the lifting of lockdown restrictions, various measures are taken by the government and the Reserve Bank of India (RBI) to keep interest rates soft and ensure ample liquidity in the system have improved sentiments and resulted in high issuances of bonds over the last few quarters in FY21.

Indian debt and rupee may lure overseas investors in 2021, just like the nation's equities, with one caveat: the central bank would face more challenges in curbing the local currency's gains against the greenback. The resulting glut of cash in the financial system has caused short-term rates to crash, which, combined with high inflation, dampens debt returns for foreign funds triggering a record outflow from bonds. Sterilization has also caught the eye of U.S. monitors who added India to their watch list for currency manipulators and may force the Reserve Bank of India to let the rupee strengthen against the dollar.

The rupee, Asia's worst-performing currency against the dollar in 2020, may rebound along with flows into debt amid a recovery in risk appetite for higher-yielding assets. India was among the five most favored markets, according to a Bloomberg survey of emerging market outlooks for 2021.

Types of International Bonds

Foreign bonds are sold outside the borrower's country but denominated in the currency of the country of issue. So for example, A French company floating a bond issue in London in pounds would be issuing foreign bonds.

Eurobond is a bond issue sold in a currency other than that of the country of issue. For example, a French company issuing a bond in London, denominated in the U.S. dollars, is an example of a Eurobond.

A ***Global bond*** is a Eurobond that is issued in several locations at the same time. For example, it could be U.S. dollar bond issued by a U.S. company in London, Paris, Franklin, and Hong Kong.

Offshore Financing

It is the provision of financial services by banks and other agents to non-residents. In its simplest form, this involves borrowing money from and lending to the non-residents.

A US company can raise Eurodollars in London by working with a bank to issue bonds or syndicate a loan. A good example of legitimate offshore financing is the use of Eurodollar market.

We can have another example of the State bank of India, the largest government-owned bank in India. The country's largest bank, in January 2021, raised $600 million through bonds issued to international investors at a coupon of 1.8%, which was the lowest pricing for such an issue. The bank said that the price guidance was revised from T+175 basis points to T+140 basis points on the back of strong demand. The issuance of bonds would happen through SBI's London branch. The bonds would also be listed on Singapore Exchange and India International exchange at Gujarat International Finance Tec-City (GIFT).

Indian companies could raise $300 billion via offshore bond sales in 2021.

Offshore Financial Centers

Offshore financial centres are cities or countries that provide large amounts of funds in currencies other than their own and are used as locations to raise and accumulate cash. The offshore industry is primarily a result of the increasingly globalized nature of the world's financial and commercial systems that have all but demolished territorial boundaries. This opening gave way for the utilization of local resources for global demand opening up once localized areas of commerce to an international market.

As a result, companies with business and financial transactions that were trans-national primarily became aware of the purposelessness of paying taxes in a high-tax jurisdiction. Like any self-fulfilling liberal economy, wherever there is a demand, a supplier is never far behind - and offshore tax-efficient structures filled that gap.

Offshore Financial Centres work by first offering capital a place to exist without being continuously taxed. Low tax opportunities are given to capital that remains outside the borders in which the entity is incorporated.

Offshore Financial Centres offer:

- Low tax rates
- Confidentiality laws
- Minimal regulative framework
- Strong asset protection legislation

Financial centres, such as the Cayman Islands and the British Virgin Islands, generate more than half of their country's GDP through offshore finance. A study of corporate services professionals by Vistra found in October 2020, and there was no hard consensus on how the global pandemic would affect the balance between onshore and offshore financial centres. However, one clear result was that Singapore had leapfrogged Hong Kong as a competitive financial hub.

Offshore financial centres have one or more of the following characteristics:

- a large foreign-currency market for deposits and loans
- a market that is a large net supplier of funds to the world financial markets
- a market that is an intermediary or pass-through for international loan funds
- economic and political stability
- an efficient and experienced financial community
- good communications and supportive services
- an official regulatory climate favorable to the financial industry, in the sense that it protects investors without unduly restricting financial institutions

8.3 Global Equity Market

An equity market is a market in which shares of companies are issued and traded, either through exchanges or over-the-counter markets. Equity markets are meeting points for issuers and buyers of stocks in a market economy. Equity markets are a method for companies to raise capital and investors to own a piece of a company. Stocks can be issued in public or private markets, depending on the type of issue, the venue for trading changes.

Most equity markets are stock exchanges that can be found worldwide, such as the New York Stock Exchange and the Tokyo Stock Exchange.

Initial Public Offering (IPO)

An IPO is the first sale of stock by a company to the public. It may be in the issuer's home country or in another country. Let us consider a case study to have a better understanding of the same.

Burger King India

It was founded in 1954; Burger King is the second-largest fast-food hamburger chain in the world. It is having a global network of over 18,000 restaurants in more than 100 countries. If we talk about the worldwide revenue of the chain, it was 1.78 billion U.S. dollars in 2019.

Burger King entered India in the year 2014. It was the 100th country for the company to have its presence in. Ever stone Group, a Singapore-registered private equity outfit with a 25-year master franchise for Burger King, takes care of its Indian operations.

When Burger King decided to enter India, the American hamburger chain did something it had never done before. It gave the local master franchise complete control over the menu. It was a late entrant to India's organized fast-food market as U.S. rivals McDonald's, KFC, and Subway were already here.

After studying the local food habits by its chefs travelling the length and breadth of the country, Burger King created six varieties of vegetarian sandwiches, vegetarian snickers, and entry-level products to satisfy the taste buds of vegetarians. It has already outpaced rival Starbucks and was fast competing with McDonald's, which has 472 outlets. The company was planning to open restaurants in new areas but has ruled out the regional franchise model. After having a phenomenal

run in its earlier year due to a good number of stores in a short span of time, Burger King decided to IPO for its Indian subsidiary. The fund raised through the IPO will be used to double the number of stores in India.

The company has 261 restaurants, including eight sub-franchised Burger King Restaurants across 17 states and union territories and 57 cities across India, as per the addendum. The company is one of India's fastest growing international QSR chains during the first five years of operations based on the number of restaurants.

Over FY18-20, BKIL's Revenue/EBITDA grew at a CAGR of 49%/258%, led by 2x the store strength. However, it continues to make losses at the PAT level. The same-store sales growth stood at 12.2%/29.2% in FY18/FY19. Burger King's IPO comprised a fresh issue of equity shares aggregating up to Rs 542 crore and an offer for sale of up to 6 crore equity shares by QSR Asia, the promoter. Net proceeds from the new issue were proposed to fund the rollout of new company-owned Burger King Restaurants and for general corporate purposes.

However, Burger King postponed its IPO launch in late 2020 due to the pandemic. It came with its IPO in December 2020, Dalal Street newcomer Burger King India has outpaced its more established rival West life Development, which runs McDonald's outlets in south and west of India, in market value within three days of its listing. Burger King India's shares have tripled in value since listing its market capitalization touching Rs 7,600 crore.

This case study reflects the importance of equity markets for international firms. Funds can be easily raised through IPO in foreign geographies with the help of equity markets.

The Size of Global Stock Markets

	Market share of total world equity market value
U.S.	54.5%
Japan	7.7%
UK	5.1%
China	4%
France	3.2%
Switzerland	2.7%
Canada	2.7%
Germany	2.6%
Australia	2.2%
Smaller yearbook	6.3%
Not in yearbook	8.9%

0% 10% 20% 30% 40% 50% 60%

Market share of total world equity market value

It can be seen from the above chart more than fifty percent of the equity market is taken care of by U.S. market.

■ ← Each square this size is worth $100 billion

The primary sources of influence on global stock markets are oil prices, weakness in the global economy, and weakness in the Chinese economy, and interest rates. We can see the impact of these factors on the equity market with the help of the following examples.

World stock toppled by coronavirus shock, oil price crashed.

In March 2020, Global share markets tumbled on as panicked investors fled headlong to bonds to hedge the economic trauma of the coronavirus, and oil plunged more than 30 percent after Saudi Arabia opened the taps in a price war with Russia. Saudi Arabia had stunned markets with plans to raise its production significantly after the collapse of OPEC's supply cut agreement with Russia, a grab for market share reminiscent of a drive-in 2014 that sent prices down by about two-thirds. Again, the shock in oil was seismic as Brent crude futures slid $13.53 to $31.74 a barrel in chaotic trade, while U.S. crude shed $13.45 to $27.83 on March 9, 2020.

Crude has become a bigger problem for markets than the coronavirus in early 2020. The [S&P 500] couldn't bounce if Brent continued to crater sustainably. Global equity markets posted their most prominent weekly and monthly loss since August 2019 on February 1 2020, as growing concerns about the economic impact of the coronavirus outbreak in China

Citigroup revised its full-year forecast for China's GDP growth to 5.5% in 2020 from 5.8%. The bank also cut first-quarter growth expectations to 4.8% from 6% in the fourth quarter of 2019. So all these examples indicate the impact of oil prices, weakness in the global economy, and weakness in the Chinese economy, and interest rates on the global equity market.

The Euro equity Market

Euro equities are shares listed on stock exchanges in countries other than the home country of the issuing company. For example, a euro equity IPO co-occurs in two countries different from where the company is based.

Alibaba.com listing on Hong Kong stock exchange

1999, Jack Ma and his team of 17 friends and students founded Alibaba.com, a China-based B2B marketplace site (US$16,651 million), an increase of 40% year-over-year. Annual active consumers on their China retail marketplaces reached 693 million, increasing 19 million from the 12 months ended June 30, 2019.

Chinese e-commerce giant Alibaba Group raised $12.9 billion (Euro 10 billion) in a landmark listing in Hong Kong, the largest share sale in the city in nine years, and a world record for a cross-border secondary share sale.

8.4 Role of Banks & Non-Banking Financial Corporation (NBFC)

Banks and NBFC play a critical role in international trade by providing trade finance products that reduce the risk of exporting.

Trade Finance

Trade Finance, where financial institutions provide credit facilities such as short-term finance to guarantee the exchange of goods (domestic and international), involves multiple parties on both sides of the transaction; and Payments generally through letters of credit (L.C.), or guarantees.

To remain competitive in today's changing environment, both clients and financial institutions must streamline their trade activities. As a result, firms are looking to reduce costs and improve efficiencies across the board. As per JP Morgan estimates, with trade activities requiring an average of 36 original documents, 240 copies, and the involvement of 27 entities, the Fortune 500 companies spend over USD 81 billion annually on unnecessary working capital and supply chain costs.

Since 2019, the trade finance ecosystem has continued to grow and adapt to new technologies and regulatory conditions. But even as financial institutes increasingly implement digital solutions, the Trade Finance gap persists

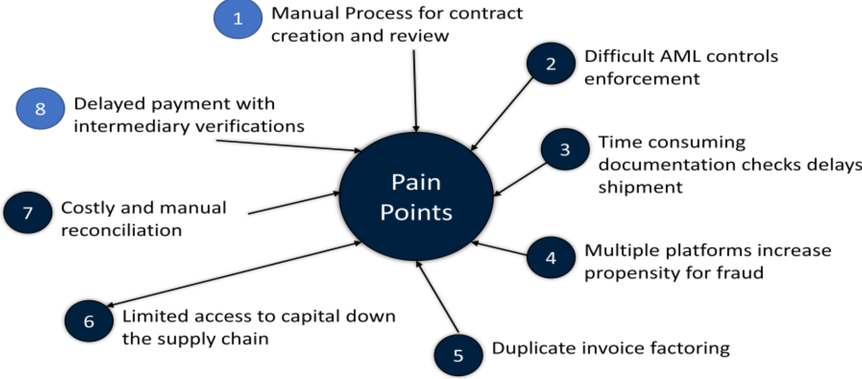
Challenges in Trade Finance Lifecycle

Challenges	Description	Operational Impact
Paper heavy process	• Flow of physical paper document like purchase orders, invoices, BOL etc. across borders throughout the transaction cycle	• Increase in transaction turnaround time • Handling & storage costs • Risk of losing or tempering important documents
Labour intensive	• Authenticity of paper documents like BOL, signatures, address is verified manually • Manual handoffs across fragmented operational processes and I.T. systems	• Manual checking is subjective & error-prone • Lack of standardization across geographies makes it difficult to scale operations • Staff development is critical, which may take as many as six months to 7 years • High staff turnover and relative inexperience increases operational risk and leads to client dissatisfaction
Legacy I.T. systems	• Fragmented and outdated legacy systems are integrated in an ad-hoc manner with manual processes by staff	• Manual handoffs increase complexity in tracking and limit efficiency improvement by automation • Low paced adoption of operationally efficient technological innovations like Bank Payment Obligation (BPO's)

These challenges need to be addressed so that the Trade Finance process can take place smoothly. As a result, it will benefit all financial institutions across the globe.

Trade Finance Pain points

Various hurdles need to be taken care of by institutions at the world level. Some of these are mentioned below.



Summary

The Corporate finance function acquires and allocates financial resources among the company's activities. The role of financial management is to maintain and create economic value or wealth by maximizing shareholder wealth.

Capital structure is how a company funds its overall operations and growth. Debt consists of borrowed money that is due back to the lender, commonly with interest expense. Equity consists of ownership rights in the company, without the need to pay back any investment.

The degree to which a firm funds the growth of the business by debt is known as leverage.

A Eurocurrency is any currency banked outside its currency of origin.

Offshore financing is the provision of financial services by banks and other agents to non-residents. In its simplest form, this involves borrowing money from and lending to the non-residents.

Offshore financial centres are cities or countries that provide large amounts of funds in currencies other than their own and are used as locations to raise and accumulate cash.

An IPO is the first sale of stock by a company to the public. It may be in the issuer's home country or in another country.

Euro equities are shares listed on stock exchanges in countries other than the home country of the issuing company. A euro equity IPO co-occurs in two countries different from the one where the company is based.

Keywords

Capital structure: is how a company funds its overall operations and growth.

Leverage: The degree to which a firm funds business growth by debt is known as leverage.

A Eurocurrency: is any currency banked outside its currency of origin.

Foreign bonds: are sold outside the borrower's country but denominated in the currency of the country of issue.

Eurobond: is a bond issue sold in a currency other than that of the country of issue.

A ***Global bond:*** is a Eurobond that is issued in several locations at the same time.

Offshore Financing: It is the provision of financial services by banks and other agents to non-residents.

Offshore financial centres are cities or countries that provide large amounts of funds in currencies other than their own and are used as locations to raise and accumulate cash.

Euro equities: are shares listed on stock exchanges in countries other than the home country of the issuing company.

Self Assessment

1. The long-term financing dimension of financial management ________.
   - A. deals with the selection, issuance, and management of long-term debt and equity
   - B. is unaffected by currency changes because everyone borrows in U.S. dollars
   - C. focuses on the analysis of investment opportunities =
   - D. is independent of the capital structure of an MNE

2. Acquiring and allocating financial resources among the company's activities and projects is the responsibility of the ________.
   - A. the accounting function of the firm
   - B. external auditors
   - C. CFO
   - D. financial marketing manager

3. The financial management activity that determines the proper mix of debt and equity is ________.
   - A. capital structure
   - B. long-term financing
   - C. capital budgeting

D. working capital management

4. In a country like Russia, where there is a great deal of corruption, an MNE would most likely use ________ to fund corporate activities.
A. equities
B. debt
C. cash
D. countertrade

5. The degree to which a firm funds the growth of a business by debt is known as ________.
A. leveraging
B. equity financing
C. hedging
D. the after-tax cost of debt

6. MNEs most likely use offshore debt markets ________.
A. to hide their cash from tax authorities
B. to take advantage of their ability to access capital in different countries
C. since debt in foreign countries is always cheaper than in the home-country market
D. because investors don't like to invest in companies that only raise capital in their home

7. What term refers to a currency on deposit outside its country of issue?
A. Eurocurrency
B. Eurodollar
C. Euroyen
D. Euro pound

8. Which of the following is NOT an advantage associated with Eurocurrencies?
A. more convenience for users
B. better yield for lenders
C. tighter U.S. regulation
D. cheaper lending rates

9. The global capital market offers all of the following advantages to firms EXCEPT ________.
A. short-term financing options
B. numerous investment opportunities
C. a wide array of financing sources
D. financing at a reduced cost

10. A bond that is issued by Nestle, a Swiss company, which is denominated in yen and sold to residents of Japan is most likely a ________.
A. Eurobond
B. global bond
C. foreign bond
D. country fund

11. Brooke buys shares of stock in a small bakery in a foreign country in return for an ownership position and promised capital gains. This is an example of ________.
A. equity securities
B. debt financing
C. playing the stock market
D. investing in Euro equities

12. The stock market is also known as the ________.
A. capital market
B. foreign-exchange market
C. bond market
D. equity capital market

13. A firm would decide to delist its stock from a foreign stock exchange for all of the following reasons EXCEPT ________.
A. the best price for the stock is in the home market
B. there is an increased regulation in that particular foreign market

C. there are weak market returns on the stock
D. there are high trading volumes on the stock

14. ________ focus on offering banking and other financial services to non-resident customers.
A. Subsidiary banks
B. Branch banks
C. Affiliated banks
D. Offshore financial centres

15. Which of the following is an example of crypto currency?
A. U.S. dollar
B. Japanese yen
C. Bitcoin
D. Euro

Answer for self Assessment

1.	A	2.	C	3.	A	4.	B	5.	A
6.	B	7.	A	8.	C	9.	A	10.	C
11.	A	12.	D	13.	D	14.	D	15.	C

Review Questions

1. Why do many MNEs acquire external funds through the Eurodollar market?

2. What are the major sources of external funds for an MNE's normal operations? Why do MNEs use offshore financial centers to raise funds?

3. What is an offshore financial center? What are the main characteristics of OFCs?

4. What do you understand by international bonds? Explain in brief the types of international bonds available in global markets.

5. What do you understand by the term Trade Finance? Explain in brief.

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UNIT 09: Global Competitiveness

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Learning Outcomes
Introduction
9.1 Exporting
9.2 Export Management
9.3 Global Competition
9.4 Economic Growth & its Impact on Environment
Self-Assessment
Review Questions
Summary
Keywords
Further Reading

Learning Outcomes

After studying this unit, you should be able to

- outline the importance of export management.
- interpret the steps involved in export management.
- illustrate the impact of global competition on international business operations.
- discuss the world economic growth and its impact on the environment.

Introduction

The history of exporting dates back to the Roman Empire, when European and Asian traders imported and exported goods across the vast lands of Eurasia. Trading along the Silk Road flourished during the thirteenth and fourteenth centuries. Caravans laden with imports from India and China came over the desert to Constantinople and Alexandria. From there, Italian ships transported the products to European ports.

Globalization leads to increased competition. This competition can be related to target market, product and service cost and price, technological adaptation, quick production by companies, quick response etc. When an organization produces less cost and sells cheaper, it can enhance its market share. Buyers have a wide multitude of choices in the market, and this lead to a change in their behaviors. Customers want to buy goods and services fast and in a more efficient way than before. They also expect quality to be maintained at high standards and low prices. All such expectations need a company's response; otherwise, its sales will decrease, and organizations will lose profit and market share. A company must always be ready for the price, product and service, and customer preferences because all of these are global market requirements.

A high economic growth rate has been a primary and permanent goal of government and society, particularly in developing countries. The enhancement in economic growth is related to the increase in the production and consumption of goods and services; consequently, this may enhance the multiplied interests of the customers and income per capita consumption. Technological development has been considered as having the potential to diminish or exacerbate the effects of economic growth; however, it depends on the net result related to increased or decreased per capita natural resource consumption.

9.1 Exporting

It is the sale of goods or services produced by a firm based in one country to customers that reside in another country.

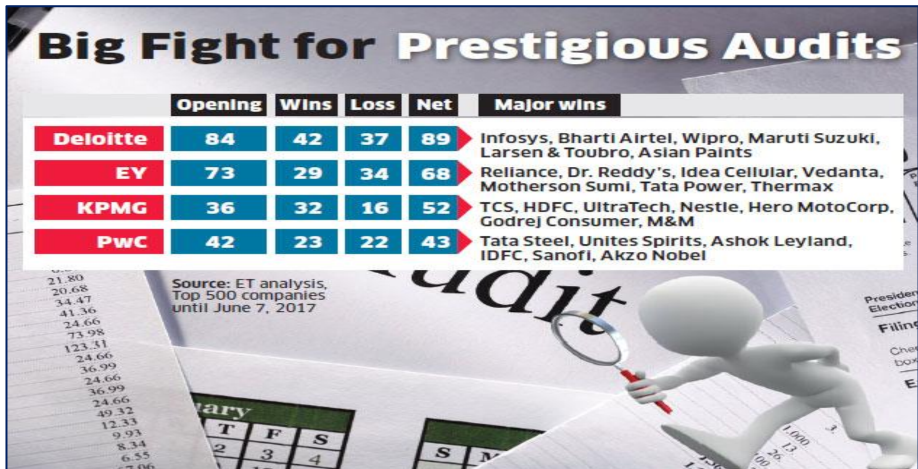
Example: Indian carmaker Tata Motors shipping (exporting) automobile made in Pune to customers (Importers) in Bangladesh.

Exports are significant to modern economies because they offer people and firms many more markets for their goods. Thus, one of the core functions of diplomacy and foreign policy between governments is to foster economic trade, encouraging exports and imports to benefit all trading parties. According to research firm Statista, in 2019, the world's largest exporting countries (in terms of dollars) were China, the United States, Germany, The Netherlands, and Japan. China posted exports of approximately $2.5 trillion in goods, primarily electronic equipment and machinery. The United States exported approximately $1.6 trillion, primarily capital goods. Germany's exports, which come to roughly $1.5 trillion, were dominated by motor vehicles—as were Japan's, which totaled approximately $705 billion. Finally, The Netherlands had exports of roughly $709 billion.

Hence we can say that exports involve any good or service traded from sellers in one country to buyers in another country. Service exports occur across a range of industry sectors. However, the sometimes hazy service standards make it a bit tougher to define what qualifies as an export. Let us take an example to understand the service exports well.

Example: KPMG bagged big business from Indian corporation in 2017.

KPMG International Limited (or simply **KPMG**) is a British-Dutch multinational professional services network and one among the Big Four accounting organizations. KPMG had reduced the gap with its competitors in the race for new audit mandates, added TCS, Mahindra &Mahindra, and HDFC to its list of important clients in 2017.



Big Fight for Prestigious Audits

	Opening	Wins	Loss	Net	Major wins
Deloitte	84	42	37	89	Infosys, Bharti Airtel, Wipro, Maruti Suzuki, Larsen & Toubro, Asian Paints
EY	73	29	34	68	Reliance, Dr. Reddy's, Idea Cellular, Vedanta, Motherson Sumi, Tata Power, Thermax
KPMG	36	32	16	52	TCS, HDFC, UltraTech, Nestle, Hero MotoCorp, Godrej Consumer, M&M
PwC	42	23	22	43	Tata Steel, Unites Spirits, Ashok Leyland, IDFC, Sanofi, Akzo Nobel

Source: ET analysis, Top 500 companies until June 7, 2017

Starting on a thin base, KPMG had made net increase to its list of top mandates: From 36, its customer base among the top 500 companies had risen to 52, with 16 exits being replaced by twice as many new additions.

Types of Exporters

- Non-exporter,
- Sporadic exporter,
- Regular exporter,

Non-Exporter

Such organizations command little or no knowledge about exporting and often have no keen interest in international trade.

Sporadic Exporter

This type of organization takes a indirect approach to assessing international trade options. It fills an unsolicited order from the occasional foreign client but prefers to focus on the domestic market.

Regular Exporter

The organization that aggressively carries out export sales as a productive, profitable, strategic activity is a regular exporter.

Let us go through an example to understand how these various types of exporters have sailed through the crisis time in pandemic

Example: Indian exporters were on edge in mid 2020 due to pandemic

One of the Jaipur-based exporter deals in home linens, garments, and paper products sensed an opportunity as Chinese factories closed due to a strict lockdown. They were hopeful that the pandemic would benefit them in India, but that did not happen as planned out. U.S. retailers such as Saks Fifth Avenue, Neiman Marcus, and Pier 1 Imports have filed for bankruptcy. Textiles manufacturers found themselves competing against deeply discounted prices set at liquidation sales of such companies. The above mentioned is an example of regular exporters that felt as if there was no way out for them. It was quite an unfortunate year for most of the exporters all around the globe.

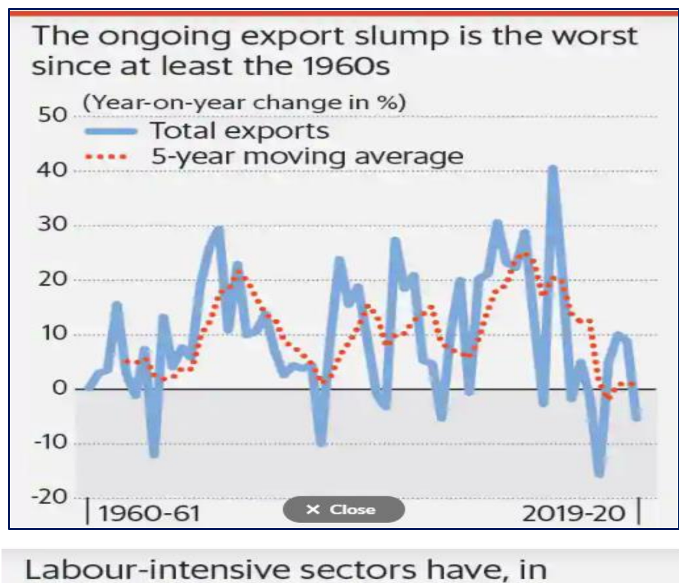
For export-oriented firms, reliant on a narrow band of commodities ranging from jewelry to garments and leather, those were the worst of times. These goods also happened to be primarily produced by India's labor-intensive small and medium-sized industries.

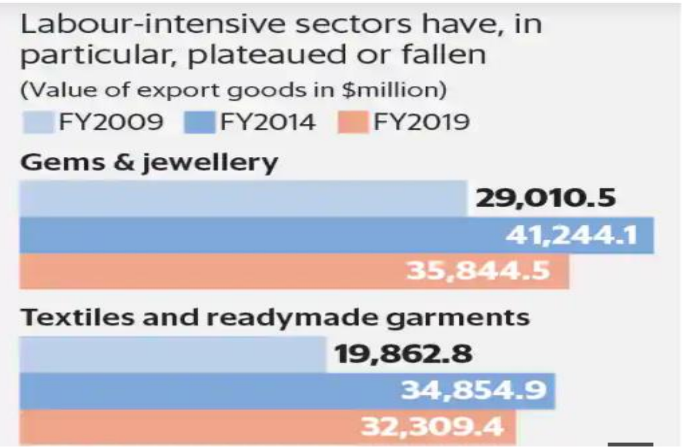
In textiles and apparel, which had been among India's top ten export items, the falling numbers of big retailers in the U.S. had left domestic companies heavily dependent on business from discount stores and the exacting demands of fast fashion companies. In addition, unexpected local challenges have amplified the pain.

Freight containers have been in short supply because the massive drop in imports had meant fewer containers were arriving at Indian ports. Production costs had also increased as manufacturing unit grapple with an acute shortage of skilled migrant workers. However, the more significant problem was that the country's most labour-intensive export manufacturers have either not grown well or have declined for the last five years or so. Capital-intensive exports, from engineering goods to electronics to refined petroleum products, have done somewhat better.

The Reserve Bank of India estimated that gems and jewelry, and real estate were the sectors with the highest quantum of bad loans, about 25%. While the rupee remained overvalued, it could liquidate many labor-intensive export firms in the year 2020. In the past five years, leather exports have gone down from $6.2 billion to $4.8 billion, textiles and garments from $34.8 billion to $32.3 billion, and gems and jewelry from $41.2 billion to $35.8 billion.

The exports from India had a bleak outlook in 2020. The same can be seen with the help of the charts below.





The same thing was seen with exporters or suppliers of glass vases and platters to retailers such as Armani's home division and Crate & Barrel. The good news was the return of U.S. buyers who had been lost to Chinese manufacturers six years ago. Yet, the victory over China was dampened by having to deal with the higher cost of compressed natural gas needed for factories and the high cost of soda ash, a main ingredient for glass-making.

Soda ash was much affordable in other countries. The US was a major producer. But the Indian government wanted to boost the domestic market (for soda ash). That was the only thing the government was thinking. In an example of small, labour-intensive factories being disadvantaged to protect big companies, the main producers of soda ash in India happened to be Tata Chemicals, Gujarat Heavy Chemicals Ltd., and Nirma. However, in 2019, the commerce ministry launched an investigation into whether Turkey had subsidized its soda ash exports to India.

India had made 233 protectionist interventions in the form of licensing rules, tariffs or other barriers. That muscular mercantilism created problems for most exporters who need imported components or inputs. Furniture makers, for instance, rely on China for adhesives and sanding paper. Moreover, furniture makers were expecting better demand for end tables and writing desks in the U.S. more people have started to work from home.

A shortage of trucks had meant that freight carriers had hiked charges from ₹28,000 to ₹34,000 per truckload to get his firm's products from Rajasthan to the port in Mudra. The negotiations with U.S. buyers had been complex because they knew the domestic Indian market was asleep. Exports were the only game in town.

The issue for labour-intensive exporters in India was that they were very small in size. It meant they were overlooked by successive Indian governments when decisions were made on the advantage of, for instance, a FTA with the European Union, which, along with the U.S., was India's largest trading partner. An FTA with the E.U., a work-in-progress from 2007 till discussions stalled in 2013, would benefit garment exporters competing against Bangladesh but was deadlocked in part because it would hurt automotive companies and, absurdly, wine producers in India.

This is what different types of exporters faced in general in terms of challenges and bottlenecks. So let us now understand the steps that need to be seen in export management.

9.2 Export Management

Export management is the use of the managerial process to the serviceable area of exports. It is associated with export activities and type of management that brings harmonization and incorporation of export business. For undertaking an export business, an entrepreneur should clearly understand the rules and regulations and the documentation about these export transactions. Let us know the export procedure of one of the economies like India.

Exports are governed by Foreign Trade (Development & Regulation) Act, 1992 and Export-Import (EXIM) Policy. Directorate General of Foreign Trade (DGFT) is the primary governing body responsible for the export and import policies in the country. Since an export trade has to follow a specific set of procedures from receiving inquiries to completion of the transaction exporters need to get themselves registered with these authorities for ensuring all the legal formalities as required by them are met, And also for receiving incentives which are allowed under the export promotion schemes. The Reserve Bank of India (RBI) guidelines have to be met by the exporter. An exporter also requires an Import-Export Code Number from the concerned regional licensing authority.

Export Procedure

Step 1- Receipt of an Order:

The exporter of goods must register with various authorities such as the income tax unit and Reserve Bank of India (RBI). In addition to this, the exporter has to hire an agent who can collect orders from foreign customers (importer). The Indian exporter receives orders either directly from the importer or through indent houses. (Example of small retail apparels exporters can be taken).

Step 2- Obtaining License and Quota:

After getting the order from the importer, the Indian exporter is required to secure an export license from the Government of India. Then, the exporter has to apply to the Export Trade Control Authority and get a valid license. The quota is referred to as the permitted total quantity of goods that can be exported.

Step 3- Letter of Credit:

The exporter of the goods generally asks the importer for the letter of credit, or sometimes the importer himself sends the letter of credit along with the order. A letter of credit is a document sent from a bank or financial institute that guarantees that a seller will receive a buyer's payment on time and for the total amount. Letters of credit are often used within the international trade industry.

Step 4- Fixing the Exchange Rate:

Foreign exchange rate signifies the rate at which the home currency can be exchanged with the foreign currency i.e., the rate of the Indian rupee against the American Dollar. The foreign exchange rate fluctuates from time to time. Thus, the importer and exporter fix the exchange rate mutually.

Step 5- Foreign Exchange Formalities:

An Indian exporter has to comply with certain foreign exchange formalities under exchange control regulations. As per the Foreign Exchange Regulation Act of India (FERA), every exporter of the goods is required to furnish a declaration in the form prescribed in a manner.

The declaration states:-

- The foreign exchange earned by the exporter on exports is required to be disposed of in the manner specified by RBI and within the specified period.
- Shipping documents and negotiations are required to be done through authorized dealers in foreign exchange.
- The payment against the goods exported will be collected through only approved methods.

Step 6- Preparation for Executing the Order:

The exporter should make the required arrangements for executing the order:

- Marking and packing of the goods to be exported as per the importer's specifications.
- Getting the inspection certificate from the Export Inspection Agency by arranging the pre-shipment inspection.
- Obtaining insurance policy from the Export Credit Guarantee Corporation (ECGC) to get protection against the credit risks.
- Obtaining a marine insurance policy as required.
- Appointing a forwarding agent (also known as custom house agent) to handle customs and other related matters.

Step 7- Formalities by a Forwarding Agent:

It includes –

- For exporting the goods, the forwarding agent first obtains a permit from the customs department.
- He must disclose all the required details of the goods exported, such as nature, quantity, and weight, to the shipping company.
- The forwarding agent has to prepare a shipping bill/order.
- The forwarding agent is required to make two copies of the port challans and pays the dues.
- The master of the ship is responsible for the loading of the goods on the ship. The loading is to be done on the basis of the shipping order in the presence of customs officers.
- Once the goods are loaded on the ship, the master of the vessel issues a receipt for the same.

Step 8- Bill of Lading:

The Indian exporter of the goods approaches the shipping company and presents the receipt copy issued by the master of the ship, and, in return, gets the Bill of Lading. Bill of lading is an official receipt that provides the full description of the goods loaded on the ship and the name of the port of destination.

Step 9- Shipment Advise to the Importer:

The Indian exporter sends shipment advice to the importer of the goods to get informed about the dispatch of the goods. The exporter sends a copy of the packing list, a non-negotiable document of the Bill of Lading, and a commercial invoice along with the advice note.

Step 10- Presentation of Documents to the Bank:

The Indian exporter confirms that he possesses all necessary shipping documents, namely; Marine Insurance Policy, The Consular Invoice, Certificate of Origin, The Commercial Invoice, The Bill of Lading. Then the exporter draws a bill of exchange based on the commercial invoice. The bill of exchange, along with these documents, is called the Documentary Bill of Exchange. The exporter then hands over the same to his bank.

Step 11- The Realisation of Export Proceeds:

To realize the export proceeds, the exporter of the goods has to undergo specific banking formalities. On submission of the bill of exchange, these formalities are initiated. Generally, the exporter receives payment in foreign exchange.

Let us take an example to understand how this trading procedure helps economies like India to make amendments to export policies.

Example: India's apparel export to European Union faced a duty disadvantage in 2019.

India faces competition from countries like Vietnam, Bangladesh, and Sri Lanka that enjoy preferential or duty-free access to key markets like the European Union. Apparel exports from competing countries enjoy zero/preferential access to European Union, whereas India faces a duty disadvantage. Besides, Bangladesh and Vietnam have a large and productive labour force. The E.U. typically accounted for about 30% of India's garment exports. Of course, with the U.K. out of the E.U., the bloc's share in India's supplies would drop. As a result, India's garment exports fell 4% year-on-year in FY20 to $15.5 billion.

9.3 Global Competition

Global competition is the services or products provided by competing companies that serve international customers. If you've ever looked at different television sets and wondered which one you should buy, you've analyzed global competition. The market gives you a lot of choices. You have RCA and Vizio in the United States; Sharp and Panasonic and Sony in Japan; and L.G. and Samsung in South Korea, and this is only a snapshot of the industry. These companies offer similar products, distribute worldwide, and are considered among the best of the brands. They compete on all levels, including pricing, promotion, distribution, operations, and personnel. The above mentioned aspect is the essence of global competition.

Home vs. Host Country

Home country refers to the country where the headquarters is located, whereas host country refers to the foreign countries where the company invests. Let us consider an example to understand this well.

Example: Smart T.V. industry in India

OnePlus is a Chinese company founded by former Oppo vice-president Pete Lau and Carl Pei in December 2013. It is headquartered in Shenzhen, Guangdong. The company is one of the three subsidiaries of BKK Electronics, the other two being Oppo and Vivo. This company entered the Indian market in 2014 with its smartphones.

Premium smartphone maker OnePlus came up with its smart T.V.s in September 2019 in India (Host Country), and they did that even before launching that in China (Home Country). The content is king, which remains one of the major reasons for television's continued relevance in customers' lives. Yet, the content ecosystem is quite different from one country to another. Oneplus has always had a positive relationship with content providers in India. The company has established partnerships with local and regional content providers to launch OnePlus TV in North America, Europe, and China.

Targeting the premium T.V. segment, OnePlus went ahead with its mantra of offering the best technologies at reasonable prices. Hence, for almost Rs 70,000, one could buy a smart T.V. from OnePlus, offering a 4K QLED display. It indicates that when it comes to premium smart TVs, OnePlus is here to stay and will challenge the big players in the years to come. Interestingly, several smartphone players such as Xiaomi, Samsung, L.G., and Micromax also have smart T.V.s in their product portfolio.

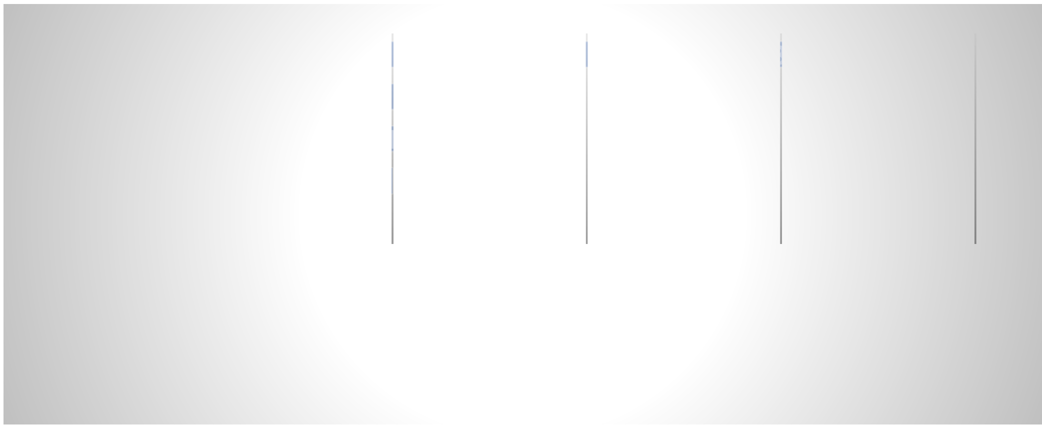
Let us consider the competition in the smart tv market in India and understand the concept of global competition. Here we will take competitors from the home country, host country as well as a third country.

Home Country

Example: Xiaomi Corporation (China)

Xiaomi Corporation is a Chinese multinational electronics company founded in April 2010 and headquartered in Beijing. Xiaomi makes and invests in smartphones, Tv, mobile apps, laptops, home appliances, bags, shoes, consumer electronics, and many other products.

Xiaomi launched its first Mi T.V. in India' ago' with the Mi T.V. 4. It got a fantastic response, with units selling out within mere seconds. At Rs 39,999, the Mi T.V. 4 was among the most affordable 4K Tvsat that point in time in the market and was expected to see a wave of consumers lining up for the flash sales. The International Data Corporation (IDC) report revealed that Xiaomi continued to lead in the India smart T.V. market, with a market share of 33 percent in Q3 2019. Samsung followed Xiaomi with a 14 percent market share, and L.G. stood at third place with a 13 percent market share. The three were followed by Sony and TCL at 10 percent and 9 percent, respectively.



Xiaomi became the number one smart T.V. brand in India. Several brands have dabbled in this smart T.V. segment in India since 2016-2019, like OnePlus, Motorola and, Nokia.

Host Country

Example: Micromax (India)

Micromax is one of the major smartphone companies in India with a huge retail presence. It is an Indian smartphone manufacturer and consumer electronics company that is based in Gurugram, Haryana, India. It also owns YU Televentures, an Indian consumer electronics brand that was formed in December 2014.

Home-grown consumer electronics firm Micromax had also forayed into the smart T.V. space. It looked to capture a 5 percent market share in the segment and 12 percent in the overall panel market when it entered in 2016. The domestic firm, which had sold 0.85 million LED TV units in 2015, was expecting to sell around 1.25 million units in 2016-17 and expanded its sales network across the country to tap the tier II & III cities, besides tapping the online platforms and modern trade channels.

Third Country

Example: Samsung (South Korea)

The Samsung Group is a South Korean multinational conglomerate headquartered in Samsung Town, Seoul. It comprises numerous affiliated businesses; most of them united under the Samsung brand and are the largest South Korean chaebol. Lee Byung-chul founded Samsung in 1938 as a trading company.

Samsung, which faced a significant threat from Huawei for the world's top smartphone brand title, was also facing heated competition in India's Smart T.V. market. The company had lost the leading smartphone brand title in India to Xiaomi, but to get more market share for the Smart T.V.s, the South Korean giant had a plan. It seemed that Samsung was looking to flood the Indian smart T.V. market access different price points. The company had launched around 20 new smart T.V. models in India in 2020. The new models would have a starting price of around ₹20,000 and would go up to ₹2,40,000. Thus, it planned to target a wide range of audiences with devices in the budget segment, mid-range segment, and high-end segment. The new Smart T.V. models from Samsung came with Personal Computer Mode, Home Cloud, Live Cast, and Music Player. The new T.V.s from Samsung also had OTT platform-related features as well.

The development came as Chinese brands (Home Country) were trying to establish themselves in the market, with Xiaomi already one of India's leading Smart T.V. brands. Therefore Samsung from South Korea (Third Country) is trying to compete against these competitors.

Similarly, China's OnePlus, which had positioned itself as a premium smartphone and smart T.V. player, had changed its strategy and was preparing to enter the mass segment in smart T.V.s, taking on the likes of Xiaomi, Realme, TCL, and other players. The move was in line with the brand's broad strategy to expand its customer base across ecosystem products and tap masses. The Chinese brand had also signaled its intention to move into the affordable smartphone category in India and globally as well.

The brand has launched its entry-level smart T.V. series at around $200 or Rs. 15,000 and also decided to launch a mid-range series is Rs 20,000-Rs 40,000 range. Entry and mid segments were overgrowing and had captured the focus of the company. If the company wanted to diversify to a wide audience in India, it was the best way to start.

But why in India these smart T.V. manufacturers were focusing on entry-level segment? The answer to it was very simple, India's entry-level smart T.V. segment (below Rs 20,000) cornered 45% of the overall smart T.V. market in the January-March quarter in 2020, while the mid-level segment (Rs 20,000-40,000) cornered a 33% market share, as per Counterpoint report Affordable smart T.V. (Below Rs 20,000) recorded 80% year-on-year growth in the first quarter of 2020. While Samsung leads the overall T.V. segment, Xiaomi was the leader in the smart T.V. segment.

OnePlus intends to increase its share thought of coming with the Indian smart T.V. market with locally-manufactured television sets that were expected to be available in India and other markets in the first half of 2020. According to an E.T. report, OnePlus aimed to make India its production hub for global exports after foraying into this category in later 2019. OnePlus would assemble smart T.V.s in India with a manufacturing partner. The Chinese smartphone maker even got in touch with contract manufacturer Dixon Technologies to assemble televisions. Dixon was already working with the likes of Samsung and Xiaomi for smart T.V.s.

Samsung also thought of resuming television production in India after 15 months in the light of new rules for the assembly of T.V. units. The company had stopped manufacturing in October 2018 thanks to 5% import duties on smart T.V. panels, which was scrapped, encouraging Samsung and other manufacturers such as OnePlus to restart manufacturing in India. In addition, onePlus was going to expand television distribution beyond e-commerce to other large-format sellers, OnePlus thought of having 100 stores in 50 cities by December 2020.

In recent times, consumers are going for more affordable options thanks to the rich feature set and the smart T.V. experience on a budget. The rise in sales of cheaper television units had forced Samsung, Sony, and L.G. to drop prices by 20%-40%. However, smart television is just 10% of the market, and there is immense growth potential.

Anyone can make an electric car (many brands are now doing it), but no one can get close to a Tesla. Tesla was at least ten years ahead of the competition. The same goes with Xiaomi who was category lead for smart T.V.s in India, a crude analogy, to compare Xiaomi with Tesla but seemingly backed by logic. Anyone can make an Android T.V. but making the whole experience better is what's going to take a lot of time for many players. And Xiaomi was at least a year, year, and a half lead over any other brand launching a smart T.V. in India in 2020. Xiaomi chose the route less traveled. The company approached 50 of its Mi Preferred partners in Karnataka and asked them to list their T.V.s. The initial response was just about okay because people didn't usually expect T.V.s inside a mobile store. But once they got aware, things started picking up. Xiaomi would expand to over 2,000 such outlets, a model that their competition has started copying as well.

Around the same time, Xiaomi had also started expanding its Mi Stores. Xiaomi had over 5,000 Mi Stores in India in 2020. It was a risk but a risk worth taking. With a 20% market share, Xiaomi was the third-largest smart T.V. brand in India regarding offline sales in 2020. In the middle of all this, Xiaomi was also working on an even bigger plan to potentially make its smart T.V.s in India. In fact, it had been looking for partners even before the launch. In October 2018, Xiaomi partnered with Dixon Technologies and started a local assembly at Tirupati, Andhra Pradesh. As a result, over 85% of Xiaomi Mi T.V.s were made in India that reflected how the company was trying to fit itself in Indian culture.

Now the question that needs to be addressed here is why competition has got so intense? The answer lies in the year 2017-18. That period saw some considerable changes in terms of how India was consuming content. Data was getting both cheap and fast. Of course, Reliance Jio had a lot to do with it, but because of it, everybody else also followed suit. India was waking (and warming) up to content streaming. It started primarily with YouTube, and eventually, the likes of Hotstar began to getting traction with events like IPL being streamed by millions concurrently. And the various OTT platforms helped this segment to grow at a rapid pace.

So this example of smart tv market in India has explained the concept of global competition and clarifies the distinction among home, host, and third-country terminologies.

9.4 Economic Growth & its Impact on Environment

The sustainable development concept recognizes that economic growth and environmental protection are inextricably linked but not necessarily opposed. For example, the environmental impact of economic growth includes the increased consumption of non-renewable resources, higher levels of pollution, global warming, and the potential loss of ecological habitats. However, not all forms of economic growth cause damage to the environment. For example, with rising real incomes, individuals have a more remarkable ability to devote resources to protecting the environment and mitigating pollution's harmful effects. Also, economic growth caused by improved technology can enable higher output with less pollution.

We can consider the crisis due to a pandemic that impacted globally in the year 2020. Policymakers are supposed to move decisively. Although it is already growing again following the 4.3 percent contraction of 2020, the COVID-19 pandemic has caused a heavy toll of deaths and illness, plunged millions into poverty may depress economic activity and incomes for a prolonged period. Immediate policy priorities should focus on controlling the spread of coronavirus and ensuring rapid and widespread vaccine deployment. To support recovery in the economy, authorities also need to facilitate a re-investment cycle aimed at sustainable growth less dependent on government debt.

The formidable challenges that are in front of the economies from different parts of the world are:

- Public health,
- Debt management,
- Budget policies,
- Central banking and,
- Structural reforms

To overcome the impacts of the pandemic and counter the investment headwind, there needs to be a major push to improve business environments, increase labor and product market flexibility, and strengthen transparency and governance. The collapse in global economic activity in 2020 due to the onset of the pandemic is estimated to have been slightly less severe than previously projected, mainly due to shallower contractions in advanced economies overall and a more robust recovery in China, the forecast states. However, for most emerging markets and developing economies, the impact was more acute than expected. In addition, financial fragilities in many of these countries, as the growth shock impacts vulnerable household and business balance sheets, would also need to be addressed.

If the variables in the near-term remain "highly uncertain," the World Bank warned that it could limit global expansion in the year 2020 to just 1.6 percent. Meanwhile, with successful pandemic control and a faster vaccination process, global growth could accelerate to nearly five percent in an upside scenario. According to the world bank prospects, aggregate GDP in emerging markets and developing economies, including China, is expected to grow 5% in 2021, after a contraction of 2.6%.

The Prospects also examine how the pandemic has amplified risks around increasing debt and its impact on long-term growth. The pandemic has greatly exacerbated debt risks in emerging markets and developing economies.

Weak growth prospects will likely further increase debt burdens and erode borrowers' ability to service debt. The global community needs to act rapidly and forcefully to ensure the recent debt accumulation does not end with a string of debt crises. The developing world cannot afford another lost decade. The pandemic is expected to leave long-lasting adverse effects on global activity, the World Bank warns, with a likely slowdown in global growth stretching through the next decade, due to underinvestment, underemployment, and labour force declines in many advanced economies.

The global economy could be heading for a decade of growth disappointments unless policymakers put in place comprehensive reforms to improve the fundamental drivers of equitable and sustainable economic growth. Policymakers need to continue to sustain the recovery, gradually shifting from income support to growth-enhancing policies. In the longer run, in emerging markets and developing economies, policies to improve health and education services, digital infrastructure, climate resilience, and business and governance practices will help mitigate the economic damage caused by the pandemic, reduce poverty and advance shared prosperity. In contrast, in the context of reduced public spending and high debt, institutional reforms to spur organic growth are significant.

Findings from Euromonitor's Global Recovery Tracker suggest that China and India would recover the fastest amongst the top ten largest economies, while the U.K. and Brazil would take the longest. India is leading the world's economic recovery with a GDP growth set to reach 9% in 2021, a strong performance led by a 12.5% forecast increase in private consumption during the festive season at the end of 2020. In the second place, China's GDP growth is forecast at 7.5% for 2021. With the country's industrial and services sectors having already recovered by October 2020, its private and consumer industries follow suit, signaling an acceleration in recovery.

In Brazil, while the energy and transportation sectors were underperforming, the manufacturing and production sectors showed signs of partial economic recovery, forecasting a 3.2% GDP growth in 2021, one of the lowest in the world. In addition, the increase in an aging population was another contributing factor to a comparatively slower recovery rate in advanced economies, such as Japan, Italy, and France.

In 2018, France called for a "Paris-Delhi-Canberra axis." In the year 2019, Germany launched its Indo-Pacific strategy. These moves were an implicit recognition of just how much the center of the world's economy and political system had shifted eastward in recent years. The U.K. was joining the fray, with ambitious plans for a post-Brexit "Global Britain" that had stronger ties to the Indo-Pacific, where many of its former colonies reside. The question that needs to be addressed here is how did Brexit impact the United Kingdom? The answer to the same lies in:

- Growth
- Jobs
- Trade

The U.K. has already suffered from Brexit. The economy has slowed, and many businesses have moved their headquarters to the E.U. Brexit's biggest disadvantage was its damage to the U.K.'s economic growth. Most of this had been due to the uncertainty surrounding the outcome. Uncertainty over Brexit slowed the U.K.'s growth from 2.4% in 2015 to 1.0% in 2019. The U.K. government estimated that Brexit would lower the U.K.'s growth by up to 6.7% over 15 years.

Brexit has hurt Britain's younger workers the most. Germany was projected to have a labor shortage of 3 million skilled workers by 2030. Those jobs would not be as readily available to the U.K.'s workers after Brexit. Employers were having a harder time finding applicants. One reason was that EU-born workers left the U.K., their numbers falling by 95% in 2017. This had hit the low-skilled and medium-skilled occupations the most.

The U.K. should have negotiated new trade agreements with countries outside of the E.U., which had more than 40 trade agreements with 70 countries already in place. Real GDP Forecast (Morgan Stanley)

	2020E	2021E		2022E	
	MS	MS	Consensus	MS	Consensus
GLOBAL	**-3.5**	**6.4**	**5.4**	**4.4**	**3.7**
DEVELOPED MARKETS	**-5.4**	**5.1**	**4.2**	**3.9**	**2.7**
United States	-3.5	5.9	3.8	4.1	3.0
Euro Area	-7.2	5.0	5.2	3.9	2.8
Japan	-5.2	2.4	2.5	2.4	1.5
UK	-11.4	5.3	5.5	5.5	3.0
EMERGING MARKETS	**-2.0**	**7.4**	**6.3**	**4.7**	**4.5**
China	2.3	9.0	8.0	5.4	5.4
India	-5.7	9.8	8.3	6.0	5.6
Brazil	-4.0	4.3	3.5	2.7	2.5
Russia	-4.0	3.4	3.0	3.2	2.3

Source: Bloomberg, Haver Analytics, IMF, Morgan Stanley Research forecasts; Note: Aggregates are PPP-weighted.

In the 2021 outlook, the economics team at Morgan Stanley Research said the V-shaped recovery that the team forecasted in their 2020 midyear outlook was entering a new self-sustaining phase and was on track to deliver 6.4% GDP growth in the year 2021. Three key factors would characterize the next stage of the V-shaped recovery: synchronized global growth, an emerging-market rebound, and inflation return.

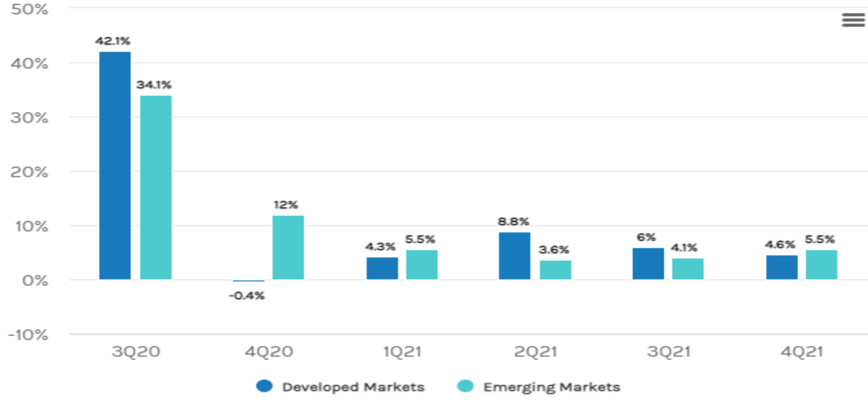
Global Growth in Sync

World economies rarely move in lockstep. Asynchronous global recovery, where growth in both developed and emerging markets accelerate in the same year, has happened only a dozen times over the past 40 years, the last in 2017. The stage could be set for another such sync beginning in the second quarter of 2021. Initially, emerging markets would likely drive global GDP growth; then, developed markets could add to that momentum as they emerge from winter lockdowns.

The U.S. economy, for its part, has stayed resilient through the pandemic. In addition, consumer spending has nearly returned to pre-COVID-19 levels. These and other factors suggested a sustainable U.S. recovery, even amid a difficult winter, with projected GDP growth of 5.9% in 2021.

In Europe, where many countries began reimposing COVID restrictions in October 2020 as new infection rates climbed, growth was expected to resume as economies reopen. However, the economics team forecasted 5% GDP growth in 2021, slightly below the consensus estimate.

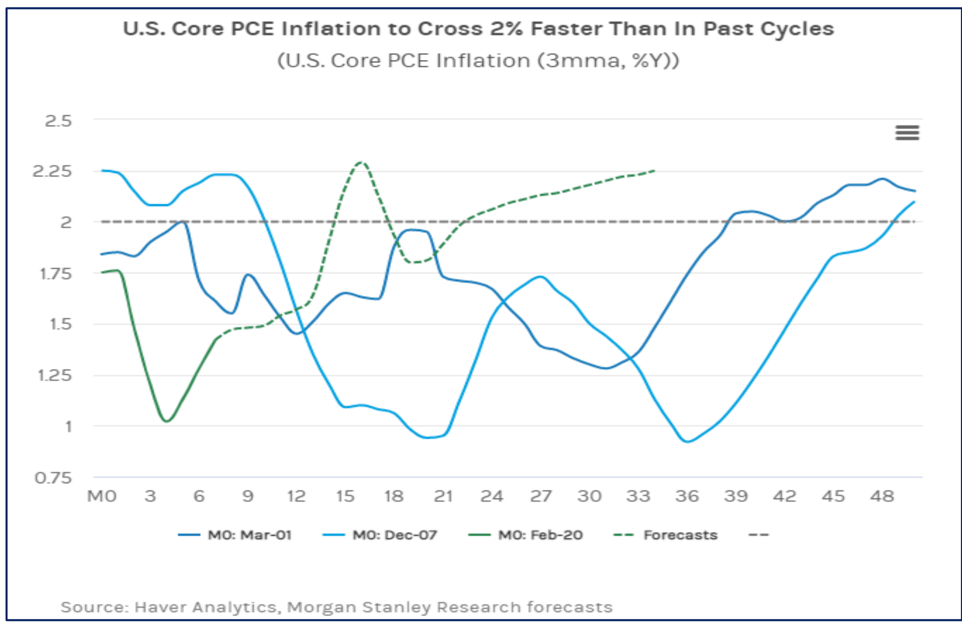
However, the team's 2022 outlook for the euro zone pegs GDP growth at 3.9%, versus a consensus estimate of 2.8%. With ongoing policy support, the initial rebound should turn into a robust recovery.   Real GDP Forecast (Morgan Stanley)



Source: Haver Analytics, IMF, national sources, Morgan Stanley Research forecasts; Note: Developed markets and emerging markets GDP includes economies under Morgan Stanley coverage, and the real GDP growth is PPP-based GDP-weighted averages

Emerging markets, excluding China, have faced numerous cyclical challenges in recent years. However, with more favorable COVID-19 dynamics in many developing nations, emerging markets could set the pace for global growth. Trade-dependent economies, like Korea and Taiwan, are already well into their recoveries. In contrast, in the large, arguably more domestic demand-oriented economies, like India and Brazil, several indicators have recently exceeded pre-COVID-19 levels and are registering positive year-on-year growth.

The pandemic has caused an unemployment spike to levels not seen in generations, and policymakers are expected to do whatever it takes to create jobs and return employment to pre-COVID levels as quickly as possible—even as economic output improves. Those stimulus policies will eventually pressure wages upward, lifting inflation.



These reflationary policies would also have critical implications for global growth, and especially for emerging markets, because of a shift in the U.S. savings-investment balance; this change in regime would, in turn, drive U.S. dollar weakness and ultimately set the scene for a reflationary impulse for the rest of the world. The report from Morgan Stanley said that the growth would be mainly due to five factors. These include lower risk of broad-based lockdowns in most key emerging markets, additional acceleration in development as a vaccine might be available from January 2021. Rising support for external demand from developed markets, against a backdrop of a widening U.S. current account, low U.S. rates, a weak U.S. dollar, and rising commodity prices. Lastly, China's growth impulse and the lagged effects of emerging market monetary easing and liquidity provisions.

Future Outlook for Economic Growth

Lockdowns, closed borders, and other social distancing measures take an immediate toll on the economy while borrowing to fund fiscal spending that helps alleviate these short-term problems will likely leave a long-term overhang on the more indebted countries. The issue is even more acute for many emerging markets, which were already in a precarious situation before the pandemic struck. The way in which these problems will play out in this diverse range of countries once hailed collectively as the future of global growth, many countries that imposed lockdowns will face huge pressure from a fiscal perspective, as sharp deficits due to subdued economic activity translate into increased government debt. Yet, some countries can get away with it, especially those with widespread trust in their fiscal and monetary institutions. This is not true for countries with a history of hyperinflation, currency crises, or balance of payments problems.

Central bankers are also constrained by the fact that traditional monetary policy techniques are not as powerful as they used to be, putting more pressure on fiscal measures to address economic problems. For example, there is a school of thought that countries can print money to meet their spending requirements. This is fine until the point where you print into an inflationary constraint, and even knowing where the tipping point is can be difficult.

Self-Assessment

Multiple-Choice Questions

1. Which of the following transactions refers to the sale of goods or services produced by a company based in one country to customers that reside in a different country?
   a. importing
   b. counter trading
   c. exporting
   d. freight forwarding

2. ________ are among the fastest-growing economic activities in the world.
   a. Global manufacturing and supply chain management
   b. Accounting and taxation
   c. Finance and human resources
   d. Exporting and importing

3. Iverson Products is a U.S. firm that is considering expanding internationally by exporting. Which of the following is the LEAST likely benefit for Iverson?
   a. boosting marketplace flexibility
   b. improving economies of scale
   c. facing lower business risk compared to other foreign market entry options
   d. requiring fairly few resources

4. This spring break, you plan to leave the United States and visit London, where you will stay in a hotel for ten days. The London hotel will be performing a(n) ________.
   a. indirect merchandise export
   b. merchandise export
   c. service export
   d. service import

5. The benefits of retaining a core competency within a company and purposefully threading that core competency through the value chain are referred to as ________ advantages.
   a. internalization
   b. domestic
   c. location
   d. ownership

6. Companies are likely to export products abroad in all of the following situations EXCEPT ________.
   a. when their average cost per unit of home country production declines substantially by increasing output
   b. when they want to use the riskiest but most profitable method to engage international trade
   c. when they aim to increase the degree of market diversification
   d. when they are new to international business

7. Boyce Dynamics, a U.S. maker of LED flashlights, fills unsolicited orders from foreign buyers. It has not proactively investigated international trade options. Boyce Dynamics is best categorized as a ________.
   a. regular exporter
   b. non-exporter
   c. sporadic exporter
   d. domestic exporter

8. Barton Accessories has two retail stores and one production facility where the firm's line of leather belts and purses is assembled. Barton employs 430 people and generates nearly $1 million in revenue each year through domestic and international sales. Which term best describes the status of Barton?
   a. SME
   b. MNE
   c. MNC
   d. FDI

9. _____________is the services or products provided by competing companies that serve international customers.

a. Global competition
b. Domestic competition
c. Third country competition
d. None of these

10. __________country refers to the country where the headquarters is located.

a. Host
b. Home
c. Third
d. None of these

11. Which of the following is among the factors that would increase a firm's probability of exporting?

a. low domestic productivity
b. high domestic labor costs
c. high level of efficiency
d. high R & D demands

12. Who will take care of the structural reforms in an economy?

a. Government
b. Multinational companies
c. Domestic company
d. None of these

13. The probability that a business is engaged in exporting tends to ________.

a. decrease with the size of the firm
b. increase with the product life cycle
c. decrease with the product life cycle
d. increase with the size of the firm

14. Which of the following is not a challenge in front of the policymakers of different economies in general?

a. Debt management
b. Public health
c. Structural reform
d. None of these

15. An Australian company makes athletic wear for women, men, and children. After several years of successfully exporting its products to the U.K. and the U.S., the company began exporting to Japan. This is an example of ________.

a. a born-global company
b. a location advantage
c. incremental internationalization
d. third-party exporting

Answer

1	c	2	d	3	b	4	c	5	a
6	b	7	c	8	a	9	a	10	b
11	c	12	a	13	d	14	d	15	c

Review Questions

1. What do you understand by exporting?

2. What do you understand by service exports? Explain in brief with the help of an example.

3. Differentiate between home and host country in global competition along with an example.

4. What do you understand by global competition? Explain with the help of an example.
5. Explain in brief how the global economic growth is shaping up during the pandemic time.

Summary

Exporting is the sale of goods or services produced by a firm based in one country to customers that reside in another country.

Export management is the use of the managerial process to the serviceable area of exports. Therefore, it is associated with export activities and type of management that brings harmonization and incorporation of export business.

Global competition is the services or products provided by competing companies that serve international customers.

Home country refers to the country where the headquarters is located, whereas host country refers to the foreign countries where the company invests.

The environmental impact of economic growth includes the increased consumption of non-renewable resources, higher levels of pollution, global warming, and the potential loss of ecological habitats. However, not all forms of economic growth cause damage to the environment.

Keywords

Exporting: It is the sale of goods or services produced by a firm based in one country to customers that reside in another country.

Sporadic Exporter: This type of company takes a passive approach to assessing international trade options. It fills an unsolicited order from the occasional foreign buyer but prefers to focus on the domestic market.

Home country: It refers to the country where the headquarters is located in international business.

Host Country: It refers to the country where the company is currently doing its business.

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UNIT 10: Internationalization Strategies

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Objectives

After studying this unit, you should be able to

- comprehend the concept of internationalization
- illustrate theories of internationalization that impact international business operations
- discuss the various modes of operations in international business
- analyze the export and import strategy in international business

Introduction

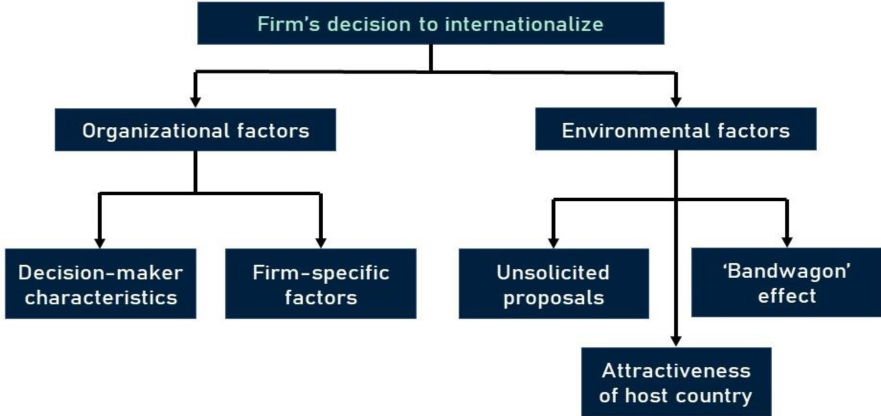
Internationalization describes designing a product in a way that it may be readily consumed across multiple countries. This process is used by companies looking to expand their global footprint beyond their domestic market and understanding consumers abroad may have different tastes or habits. Internationalization often requires modifying products to conform to a given country's technical or cultural needs, such as creating plugs suitable for different types of electrical outlets. When a company seeks to sell its goods abroad, it may find that there are several roadblocks in the way. Some may be technical barriers that need to be overcome; for instance, different voltages of household electricity or different plug shapes found worldwide. These may be remedied via technological adaptations. Other barriers may be cultural; for instance, in India, many Hindus do not eat beef. This means that to internationalize, McDonald's must focus on chicken, fish, and other non-beef menu items that better conform to local custom and culture. Being able to adapt flexibly lends itself to greater internationalization.

10.1 Internationalization

Internationalization can refer to a company that takes steps to increase its footprint or capture more significant market share outside of its country of domicile by branching out into international markets. Internationalization describes designing products to meet users' needs in many countries or designing them so they can be easily modified to achieve this goal.

The fundamental question that arises over here is why certain firms are engaged in international business activities while others are not? The answer to the same lies with organizational factors arising from within the firm and environmental factors outside the firm's control. Let us understand these factors first.

Factors Behind the Decision to Internationalize



If we consider the decision-maker characteristics under organizational factors, it constitutes the following points.

Decision Making Characteristics

- Foreign travel & experience abroad
- Foreign language proficiency
- The decision-maker background
- Personal characteristics

Here we can see the importance of having foreign exposure within the organization. If the organization's employees have experience working in foreign countries and know the local language of the region, it's an add on advantage to the company.

Firm-Specific Factors

There are two firm-specific factors:

- Firm Size
- International Appeal

In this factor, an organization considers the size of operations that it can undergo in production. The organization will also consider whether the product or service offered by it is having an international appeal or not.

Environmental Factors

It consists of:

Unsolicited Proposals

An unsolicited proposal is a written application for a new or innovative idea submitted to an agency on the offeror's initiative to obtain a contract with the government.

The bandwagon effect

The bandwagon effect is a psychological phenomenon in which people do something primarily because other people are doing it, regardless of their own beliefs, which they may ignore or override. This tendency of people to align their beliefs and behaviours with those of a group is also called a herd mentality.

The attractiveness of the Host Country

The foreign country where the organization is trying to expand its operations needs to evaluate the host country's attractiveness. For example, whether the demand for its product would be there or not, what sort of competition is available in that region, and other aspects of porter's five forces model.

We are discussing the various factors that lead to internationalization, but here we are also supposed to answer an important question. Why would a company want to invest in a foreign location, given that foreign investment is more expensive and riskier than exporting and franchising?

Let us now understand the various motives that lead to establishing an investment in a foreign location. These are:

- Natural Resource Seeking
- Market Seeking
- Efficiency Seeking
- Strategic Asset Seeking

These days, many companies take the step to establish themselves abroad. The motives for internationalization are many. Perhaps the home market is saturated, presence in a certain country grants access to strategic resources, or cluster effects are explored in a specific region. The companies that are becoming international have different experiences, are in different situations, and consider other motives before taking the step into the international market. Like we can talk about strategic asset seeking, strategic assets sit at the intersection of tangible and intangible assets and create recurring benefits, are unique, and difficult to imitate. Such strategic assets can include intellectual property, customer relationships, proprietary business processes and algorithms, novel revenue streams, and brand value.

The Internationalization process

Internationalization of the firms is a process in which the firms gradually increase their international involvement. Typically, firms start exporting to a country via an agent, later establish a sales subsidiary, and eventually begin production in the host country.

Let us now understand the factors that play an important role in the internationalization process. These are:

- Timing of market entry
- Obstacles to internationalization
- Perceptions of managers
- Psychic distance and internationalization

We can take an example to have a better understanding of these factors.

Groupe PSA entry strategy in India

If we talk about Groupe PSA, it is a 75 Billion Euro, Europe's second-largest carmaker after Volkswagen. It started way back in 1966, and It sells three brands - Peugeot, Citroen, and DS. European auto major Groupe PSA had decided to postpone its first model in India to the first quarter of 2021 due to the challenging business environment in 2020, owing to coronavirus pandemic. The company, which was all set to introduce C5 Air cross later in 2020, had planned to launch the SUV in the first quarter of 2021. We can see the importance of timing while entering into a foreign market.

Groupe PSA in India and its dealers, agencies, and vendors understood the challenges to business due to the pandemic, as the global business isolation impacted all multinational projects. Therefore, the re-timing was aimed to move the commercial launch to a potentially more positive economic activity period where consumer sentiments would be upbeat. At the same time, Groupe PSA had decided to maintain the project timeline and investment for the C-Cubed program. As a result, the first vehicle designed, developed, and made in India would be launched in 2021, as announced in 2019.

The automaker had formally announced in early 2019 its plan to enter the Indian market with Citroen brand. The brand has already stated to roll out five models in India. In addition, it has already established leasing and finance arms in the country to make the C5 Air cross SUV and other upcoming models accessible for the consumer financially. This group had not entered India for the first time prior as well. Peugeot, once considered a partner for Maruti Udyog Ltd before Suzuki took that role, entered India in 1994 through a partnership with Premier Automobiles Ltd.

Their first product. Peugeot 309 sold around 10,000 units in the first year. But labour unrest and mounting losses forced Peugeot to exit the joint venture and also India by 1997.So we

can see the obstacles that can create issues for the brand to establish in the market. In another attempt in 2011, Groupe PSA even laid the foundation for a factory in Gujarat's Sanand, aimed at producing over 170,000 units annually. But even this plan was later shelved due to their financial woes globally.

The €75 billion French auto major Groupe PSA had announced a major expansion of its business in India with its entry into the Indian independent aftermarket segment through its global multi-brand label Eurorepar, a move aimed at attracting more customers and establishing the brand in the country. The company entered the Indian independent aftermarket with a sales and distribution tie-up with Go Mechanic, a technology-enabled aggregator of local car workshops for multi-brand car servicing.

This was a unique strategy that group were creating the aftermarket ecosystem before the launch of its first car, which would be rolled out in early 2021. The organization would come out with a full range of quality parts with the service support from Go Mechanic. Eurorepar was Groupe PSA's multi-brand parts, and accessories range for the repair and maintenance of vehicles, and the range was sold in more than 50 countries.

The aftermarket multi-brand business, one of the pillars of the Push to Pass strategic plan for global markets by Groupe PSA's, aimed at fulfilling all customers' after sales expectations worldwide, regardless of their purchasing power and the make and age of their vehicle. Eurorepar was a key part of its customer-centric strategy, and products under this range would be available for three or more-year-old vehicles. The organization believed this strategy would help established Groupe PSA more firmly in India and conquer a large customer base.

Some of the common obstacles to internationalization are:

- Liability of foreignness
- Liability of expansion
- Liability of smallness
- Liability of newness

10.2 Internationalization theories

The Internationalization theory of the MNC is concerned with entry mode choices in single markets based on transaction cost analysis. Internationalization theory has an important implication of lacking foreign market knowledge, which suggests that foreign market penetration in a single market follows a path of increasing commitment from no regular export activities through export by agents and licensing agreements to the more commitment intensive establishment of sales subsidiaries, joint ventures, and overseas production units. As experimental knowledge about particular markets accumulates, internationalization theory suggests that risk exposure is attenuated, and firms escalate their resource commitments from low to high investment intensive foreign entry modes. In other words, if there is lacking knowledge about foreign markets, firms limit their risk exposure by limiting resource commitment.

The three most popular internationalization theories are:

- Uppsala Model
- The Network Approach
- International New Ventures/Born global

Uppsala Model:

The Uppsala model is a theory that explains how firms gradually intensify their activities in foreign markets, and it is being introduced by Jan-Johansson and Jan-Erik Ahlen in 1977. Their model emphasized the gradual and incremental character of international expansion. Therefore, organizations could best reduce their risk level by adopting this approach.

The Network Approach

It highlights the importance of relationships with suppliers, customers, and markets that can stimulate or help a firm go abroad .Networking is seen as a source of market information and knowledge that will bridge the gap between the involved parties' customers, suppliers, industry, distributors, regulatory and public agencies, and other market actors. Development in technology, especially in the information and communication sector, helps firms achieve a faster internationalization through the experience and resources of network partners.

International New Ventures/Born global

A born global firm as business organizations seeking resources and selling products for gaining competitive advantages from multinational markets ever since the beginning. Some examples of the same are Born Global Ninja's; Netflix, Uber, Airbnb, Spotify, and Amazon.

Netflix

Netflix's success can be attributed to two strategic moves: one is a three-stage expansion process into new markets and second the ways it worked with those markets that other companies looking to expand globally can use. First, Netflix did not try to enter all markets at once. Instead, it carefully selected its initial adjacent markets in geography and psychic distance or perceived differences between markets. For example, its earliest international expansion, in 2010, was to Canada, which is geographically close to and shares many similarities with the United States. Netflix was thus able to develop its internationalization capabilities in locations where the challenges of "foreignness" were less acute. In doing so, the company learned how to expand and enhance its core capabilities beyond its home market.

In that sense, the first phase of its globalization process was consistent with the traditional expansion model. But from the experience and learning it gained in that process, Netflix developed the capabilities to expand into a diverse set of markets within a few years, the second phase. This second phase, involving a faster and more extensive international expansion, saw Netflix extend its footprint to some 50 countries, drawing on the lessons it learned in the first phase to operate in a wider variety of markets. The choice of those markets was influenced by their degree of attractiveness, such as from shared similarities, the presence of affluent consumers, and the availability of broadband internet.

The second phase helped Netflix continue learning about internationalization and partnering with local stakeholders while also growing its revenue. Since this phase involved expanding into more distant markets, it was supported by investments in content geared toward the preferences of those geographies and technological investments in big data and analytics.

During which a much-accelerated pace of entry brought Netflix to 190 countries, the third phase used everything it had learned from the first two phases. It had gained expertise in the content people prefer, the marketing they respond to, and how the company needed to organize itself. This example reflects the usage of internationalization theory in getting established in foreign markets.

10.3 Factors Affecting Operating Modes in International Business

OPERATING ENVIRONMENT
PHYSICAL AND SOCIAL FACTORS
COMPETITIVE FACTORS
OPERATIONS
OBJECTIVES
STRATEGY
MEANS
Modes Functions Overlying Alternatives
* Self-conducted operations
* Collaborative operations

It starts with the objectives of the organization, as mentioned in the figure above. An organization can move for going international because an organization is interested in sales expansion, resource acquisition, or risk minimization. Once the domestic market is getting saturated for the organization, objectives like sales expansion will come in handy for such an organization. Similarly, if an organization believes that resources are available at a cheaper cost in some other country, this could also serve as an objective for moving into the international market. Diversification leads to risk minimization, and this could be yet another objective for organizations in moving towards international markets.

When an organization moves to the international market, the operating environment plays a crucial role as these factors are beyond the organization's control. Therefore, an organization has to pay attention to all factors that are a part of the operating environment, influencing organization operations significantly. You will be reading about the same in the next unit. Organizations will keep changing their strategies depending upon which factor is creating an impact on the organization's operations.

An organization will adopt various measures to enter the international arena, like discussing the mode of entry. An organization can opt for any of the options mentioned in the figure, like licensing, franchising, turnkey operations, importing, and exporting. It depends on which mode is best going to suit the organization considering the product or service in which the organization deals.

There are various reasons why organizations opt for different modes of entry while moving into foreign markets.

- Companies may find production abroad is cheaper than at home.
- When transportation costs are too high for moving goods or services internationally.
- When company lacks domestic capacity.
- When products & services need to be altered substantially to gain sufficient consumer demand abroad.
- When governments inhibit the import of foreign products.
- When buyers prefer products originating from a particular country.

Foreign Expansions: Alternative Operating Modes

PRODUCTION OWNERSHIP	PRODUCTION LOCATION Home country	Foreign country
Equity arrangements	a. Exporting	a. Wholly owned operations b. Partially owned with remainder widely held c. Joint ventures d. Equity alliances
Nonequity arrangements		a. Licensing b. Franchising c. Management contracts d. Turnkey operations

As discussed earlier, there are ways that an organization can opt for while entering a foreign market. It has been divided into two arrangements based on production ownership. They are:

- Equity arrangements
- None quity arrangements

An organization can opt for any of the above depending upon the various other factors discussed previously in this unit.

Global Integration Versus Local Responsiveness

Global integration standardizes worldwide activities to maximize efficiency, whereas national responsiveness adapts local activities to optimize effectiveness.

Let us understand these different modes of entry with the help of an example.

Nestle

Nestlé S.A. is a Swiss multinational food and drinks processing Conglomerate Corporation headquartered in Vevey, Vaud, Switzerland. It is the largest food company in the world, measured by revenue and other metrics. Its vision is good food. Good life anchors its mission to provide food that is a source of nourishment and satisfaction and pleasure, health, happiness, and peace of mind. Although universal in theory, these ideals differ in practice given the local habits, cultural traditions, and social norms shape the standards of preferred, palatable food from market to market. Moreover, food inputs are generally commodities, production has limited scale potential, widespread distribution faces high costs given low value to weight ratios, and promotion is best done locally given differentiated tastes, regulations, rivals, and retail channels. Hence Nestlé's designers, regulatory specialists, and consumer care representatives apply a regional outlook to customize its activities so that they respond effectively to situations in the 197 markets in which Nestle sells its products.

Let us consider an example of a country like India, where Nestle has adopted a different strategy to make inroads. It has divided the country into 15 consumer clusters, and the idea is to offer more focused solutions to consumers. How has this made a difference? The company earlier had a single strategy for the entire country. There was a national Maggi, Nescafe, or Kit Kat plan, and this was the cause of consumer disconnect. The tastes and preferences of a Maggi or Nescafe consumer in Mumbai are quite different from that of a person living in Salem in Tamil Nadu. Earlier, it was geography defining the customer and defining the brand and category, and then finally, it would touch upon the consumer. For a product like coffee, analytics has helped them target consumers based on their consumption frequency, the equity for different kinds of coffee, consumption occasion, etc.

Coffee consumption down South is a daily ritual, while in the North or in the East, coffee consumption usually happens outside of the home. Therefore, these markets need to have a

different route to marketing and distribution strategies. Painting the entire country with a singular plan was just not viable.

The Integration Responsiveness Grid

Industry pressure for Global Integration responsiveness

	Low: Adaptation and decentralization are unnecessary to sell generic products to similar markets	High: Adaptation and decentralization are needed to sell customized products to differing markets
High: Standardization and central control are imperative across international operations	Civil Aircraft Semiconductors Bulk Chemicals Institutional Banking Automobiles	Consumer Electronics Corporate Banking Electronic Commerce Paint and Pigments
Low: Standardization and central control are useful but not necessary across international operations	Goods or services that an opportunistic company sells to foreign customers	Couture Apparel Health Care Accounting Processed Food Retail Banking

Industry pressure for Local responsiveness

The integration-responsiveness framework is one of the most widely used frameworks to explain multinational corporations' strategies and organizational settings. The core idea of the framework is simple: MNCs, while going abroad, are subject to conflicting pressures for cross-border integration and local responsiveness, with industry characteristics defining where strategy is leaning to. Or putting it differently: industry characteristics define to what extent and in what combination MNC strategies seize advantages through cross-border integration and local responsiveness.

Global integration and local responsiveness are managed by different strategies adopted by multinational firms while entering a foreign market.

The International Strategy

It transfers home-country-based company competencies, such as production expertise, design skills, or brand power, to foreign markets where it does not exist or does exist but is less efficiently made or less effectively delivered.

Google develops the core architecture of its web products and platforms at the Googolplex, its headquarters complex in Mountain View, California. In addition, it allows national subsidiaries to customize aspects of their web pages to deal with local differences in language and alphabet.

On the advantage side, the international strategy works well when an MNE's products or processes speak to a universal customer preference. On the other hand, on the limitation side, headquarter confidence in the superior competitiveness of its competencies discourages local adaptation.

Multi domestic Strategy

A firm using a multi domestic strategy sacrifices efficiency to emphasize responsiveness to local requirements within each of its markets.

Nestle

Maggi, the flagship brand of the Indian arm of Swiss food and beverage company Nestlé, famed for its instant noodles, went ethnic with ready-to-eat poha and upma in 2019. The move was expected to help Nescafe Coffee and Munch chocolate maker compete with local home-grown consumer goods companies such as MTR Foods, iD Fresh Food, and Gits. The launch was in line with its efforts to diversify its portfolio and keep pace with new launches. It had introduced 61 new products for the Indian market since 2016.

With the advent of modern lifestyles and changes in consumer behaviour, Maggi had expanded its offering in the ready-to-eat segment in India with the launch of Maggi Ghee Tadka Upma Express and Maggi Masala Onion Poha Express, providing convenience and taste to its consumers, especially millennials.

MTV

MTV was first launched on Saturday, August 1, 1981, with the phrase, "Ladies and gentlemen, rock and roll," and the first music video played on MTV was "Video Killed the Radio Star" by The Bugles. Thus, since the very beginning, MTV was designed as a platform for music videos.

Rather than trying to force all of its American-made shows on viewers worldwide, MTV customizes the programming shown on its channels within dozens of countries, including New Zealand, Portugal, Pakistan, and India. So, for example, we can consider one of the reality shows from the Indian market, like MTV Roadies.

H. J. Heinz

Food company H. J. Heinz adapts its products to match local preferences. For example, because some Indians will not eat garlic and onion, Heinz offers them a version of its signature ketchup that does not include these two ingredients.

Global Strategy

A firm using a global strategy sacrifices responsiveness to local requirements within each of its markets to emphasize efficiency. This strategy is the complete opposite of a multi domestic strategy. Some minor modifications to products and services may be made in various markets. Still, a global strategy stresses the need to gain economies of scale by offering essentially the same products or services in each market.

Microsoft

Microsoft offers the same software programs around the world but adjusts the programs to match local languages. Similarly, consumer goods maker Procter & Gamble attempts to gain efficiency by

creating global brands whenever possible. Global strategies also can be very effective for firms whose product or service is largely hidden from the customer's view, such as silicon chip maker Intel. For such firms, variance in local preferences is not very important.

Transnational Strategy

A firm using a transnational strategy seeks a middle ground between a multi-domestic strategy and a global strategy. Such a firm tries to balance the desire for efficiency to adjust to local preferences within various countries.

McDonald's

McDonald's Corporation is an American fast-food company founded in 1940 as a restaurant operated by Richard and Maurice McDonald in San Bernardino, California, United States. Large fast-food chains such as McDonald's and KFC rely on the same brand names and the same core menu items worldwide. However, these firms make some concessions to local tastes too. In France, for example, wine can be purchased at McDonald's. This approach makes sense for McDonald's because wine is a central element of French diets.

10.4 Exporting

It is the sale of goods or services produced by a firm based in one country to customers that reside in another country.

Kohinoor's foods India

India's exports of basmati rice to Belgium have increased 60% in financial 2020-21, while imports by the Netherlands have almost doubled. Rising demand for basmati rice in these European countries has resulted in a better price realization for farmers. Europe was a big market for Kohinoor's foods. In the year 2020, due to the pandemic, there had been a lot of panic buying by the European market. Southeast Asian people residing in these countries have bought good quantities of basmati rice for home consumption.

Exporting: Motivation & Methods

Exporting helps companies:

- Increase profitability,

Exporting opens opportunities to increase profits. Often, companies sell their products for higher prices abroad than at home. Foreign markets may lack competitive alternatives. Or they may be in different stages of the product's life cycle. Mature products at home often face price competition, whereas growth stages in foreign markets tolerate premium prices.

- Improve productivity,

Exporting helps companies improve productivity, creating options to use scarce resources, such as capital and labour, more efficiently. In addition, productivity is often linked to increasing economies of scale, exploiting capacity, or spreading costs over more customers improves efficiency.

- Diversify activities

Exporting diversifies activities, thereby fortifying a firm's adaptability to business cycles and disruptive innovations. In addition, serving customers in different markets reduces a firm's vulnerability to the loss of a local buyer while safeguarding its bargaining power with suppliers.

Approaches to Exporting

There are two types of approaches to exporting:

- Direct Exporting
- Indirect Exporting

Direct Exporting

The company sells its products to an independent intermediary, such as an agent, distributor, or retailer outside its home country. The company manages the export process, minding all aspects of making and marketing the product.

Indirect Exporting

The company sells its products to an independent intermediary in the domestic market, which then exports the product to its foreign agents, who then sell it to the end consumer. Thus, the process results in indirect exporting.

No export approach is intrinsically superior; at the broadest level, a company's particular ownership, location, and internalization advantages determine the optimal approach. Generally, large MNE serve foreign customers directly through their foreign facilities, while SMEs may export directly or indirectly. No option is superior as such.

Importing

An import is a product or service produced abroad and purchased in your home country. Imported goods or services are attractive when domestic industries cannot have produce goods and services cheaply or efficiently. In addition, free trade agreements and tariff schedules often dictate which goods and materials are less expensive to import.

Importing: Motivation & Methods

- Specialization of labour
- Global Rivalry
- Local unavailability
- Diversification
- Top management outlook

The specialization of labour is a powerful force to improve productivity. It benefits the import potential and performance of SMEs and large firms. For instance, Nike buys shoes manufactured by companies in several Asian countries, where local companies make high-quality shoes for a lower cost. Nike finds it impossible to manufacture the same products in its home market, sell them for a reasonable price and still make a profit. As a result, it profitably imports shoes made in Asian factories into markets worldwide.

Companies import goods from foreign suppliers to lower costs. This is imperative where competitive rivalry imposes persistent cost pressures, such as in the telecommunication business in markets like India.

Local unavailability- Like Canada imports bananas from tropical climates because of its unsuitable climate.

Diversification through importing lets companies find higher quality, lower-cost products and services, thereby making them less vulnerable to the dictates of s local supplier.

Top management outlook also matters when the company takes up a decision regarding importing of products.

Types of Importers

1)Input optimizers:

This type of importer uses foreign sourcing to optimize price or quality, the inputs fed into its supply chain.

2) Opportunistic

This type of importer looks for products worldwide that it can import and profitably sell to local citizens. It identifies imperfections in the local marketplace, whether real or perceived.

3) Arbitrageurs

In principle, arbitrage is the simultaneous buying and selling of the same product in different markets to exploit the price difference.

Challenges in Exporting & Importing

Some of the major challenges faced while exporting and importing are:

- Financial Risks
- Customer Management
- International Business expertise
- Marketing Challenges
- Top Management Commitment
- Government Regulation
- Trade Documentation

Financial constraints pose tough impediments to international traders, especially the shortage of working capital to finance export. Financial concerns such as payments and taxation consistently affect companies in both manufacturing and services. An enduring barrier to exporting is misunderstanding the difficulty of profitably serving consumers in foreign markets.

The problems and pitfalls of international trade consistently frustrate the sporadic and regular exporter. International traders, like most managers dealing with foreign markets, must understand local business practices. Traders frequently complain about high shipment costs and logistic demands, weak foreign market connections, difficulties matching foreign rivals' prices, effectively promoting products and establishing distribution networks, tailoring after-sales service programs. In addition, government regulations are beyond the control of international firms and create issues in their operations. These challenges need to be addressed by international firms if they want to establish their operations in foreign markets.

Summary

Internationalization can refer to a company that takes steps to increase its footprint or capture greater market share outside of its country of domicile by branching out into international markets.

The Internationalization theory of the MNC is concerned with entry mode choices in single markets based on transaction cost analysis.

The three most popular internationalization theories areUppsala Model, The Network Approach, and International New Ventures/Born global.

Global integration standardizes worldwide activities to maximize efficiency, whereas national responsiveness adapts local activities to optimize effectiveness.

International strategy transfers home-country-based company competencies, such as production expertise, design skills, or brand power, to foreign markets where it does not exist or are less efficiently made or less effectively delivered.

A firm using a multi domestic strategy sacrifices efficiency to emphasize responsiveness to local requirements within each of its markets.

A firm using a global strategy sacrifices responsiveness to local requirements within each of its markets to emphasize efficiency. This strategy is the complete opposite of a multi domestic strategy.

A firm using a transnational strategy seeks a middle ground between a multi-domestic strategy and a global strategy. Such a firm tries to balance the desire for efficiency to adjust to local preferences within various countries.

Exporting is the sale of goods or services produced by a firm based in one country to customers that reside in another country.An import is a product or service produced abroad and purchased in your home country.

Keywords

The bandwagon effect: It is a psychological phenomenon in which people do something primarily because other people are doing it, regardless of their own beliefs, which they may ignore or override.

An unsolicited proposal: It is a written application for a new or innovative idea submitted to an agency on the offeror's initiative to obtain a contract with the government.

Multidomestic strategy: It is one of the strategies where the firm sacrifices efficiency to emphasize responsiveness to local requirements within each of its markets.

Global strategy: A firm sacrifices responsiveness to local requirements within each of its markets in favour of emphasizing efficiency. This strategy is the complete opposite of a multidomestic strategy.

Transnational strategy: It seeks a middle ground between a multi-domestic strategy and a global strategy. Such a firm tries to balance the desire for efficiency to adjust to local preferences within various countries.

Exporting: It is the sale of goods or services produced by a firm based in one country to customers that reside in another country.

Arbitrage: It is the simultaneous buying and selling of the same product in different markets to exploit the price difference.

Self Assessment

1. _________________can refer to a company that takes steps to increase its footprint or capture greater market share outside of its country of domicile by branching out into international markets.

A. Import

B. Internationalization

C. Localization

D. None of these

2. Which of the following is not the factor behind the decision to internationalize?

A. Organizational factor

B. Firm-specific factors

C. Bandwagon effect

D. Solicited proposals

3. Which of the following is not a firm specific factor?

A. Firm size

B. Foreign language proficiency

C. International appeal

D. None of these

4. ________ is the framework that managers apply to determine the competitive moves and business approaches that run the company.
A. Competition
B. Growth
C. Strategy
D. Vision

5. A strategy that focuses on lowering operating costs is referred to as a ________ strategy.
A. differentiation
B. cost leadership
C. niche market
D. diversification

6. ________ are the two basic strategies for creating value and attaining a competitive advantage in an industry.

A. Diversification and niche marketing
B. Industry leadership and market dominance
C. Customer satisfaction and product innovation
D. Cost leadership and differentiation

7. Firms that compete in the global marketplace typically face the asymmetric forces of pressures for ________ and ________.

A. global integration; local responsiveness
B. price reductions; cost reductions
C. political sensitivity; market leadership
D. cost reductions; customer satisfaction

8. Which of the following is NOT a factor driving local responsiveness among global firms?

A. cross-national differences in distribution channels
B. diverging consumer tastes and preferences
C. cross-national differences in product standards

D. host government support of freer international trade

9. In the global environment, firms use an international strategy, a localization strategy, a global strategy, or a ________ strategy.

A. regional
B. standardization
C. transnational
D. locational

10. When the pressure for global integration is high, and the pressure for local responsiveness is low, a company is most likely to pursue a(n) ________ strategy.

A. global
B. transnational
C. localization
D. international

11. Which of the following is NOT a disadvantage of the international strategy?

A. Headquarters can misread foreign-market opportunities and threats.
B. The transfer of core competencies to foreign markets is complicated by the necessity to adapt to local needs.
C. Local subsidiaries are not given the opportunity to adapt value activities and share what they have learned with headquarters.
D. The company can be blindsided by an unexpectedly innovative rival in a foreign market.

12. A driving factor for the growth in imports is the impact of ________.

A. government programs
B. labour specialization
C. consumer preferences
D. social trends

13. Federal, state, and local governments that recognize the benefits of international trade, actively aid the efforts of potential and active exporters and ________.

A. ensure the quality of exported products
B. establish barriers to punish foreign rivals
C. collect a fee for each successful export sale
D. protect the interests of struggling importers

14.The company sells its products to an independent intermediary in the domestic market, which then exports the product to its foreign agents, who then sell it to the end consumer is known as ___________.

A. Direct exporting

B. Direct importing

C. Indirect exporting
D. Indirect importing

15. Which of the following is not a type of importer?

A. Input optimizers
B. Counter trade
C. Opportunistic
D. Arbitrageous

Answer for self Assessment

1.	B	2.	D	3.	B	4.	C	5.	B
6.	D	7.	A	8.	D	9.	C	10.	D
11.	B	12.	B	13.	D	14.	C	15.	B

Review Questions

1. Discuss in brief the internationalization process.
2. Describe the theories of internationalization in brief, along with an example.
3. Describe the pressures for local responsiveness that international companies face.
4. Discuss the characteristics of international, localization, global, and transnational strategies. Include situations and a specific example in which each strategy would be most appropriate.
5. What are the three main types of importers? Briefly describe the characteristics of each.
6. What is a born global? How has technology triggered the growth of born global?
7. Discuss in brief the challenges faced by international firms while exporting and importing

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Unit 11: Forms &Ownership of Foreign Production

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Objectives

After studying this unit, you should be able to

- illustrate the need for collaborative arrangements in international business
- discuss the types of collaborative arrangements in international business
- identify the reasons that lead to the failure of collaborative arrangements
- discuss the ways of managing international collaborations

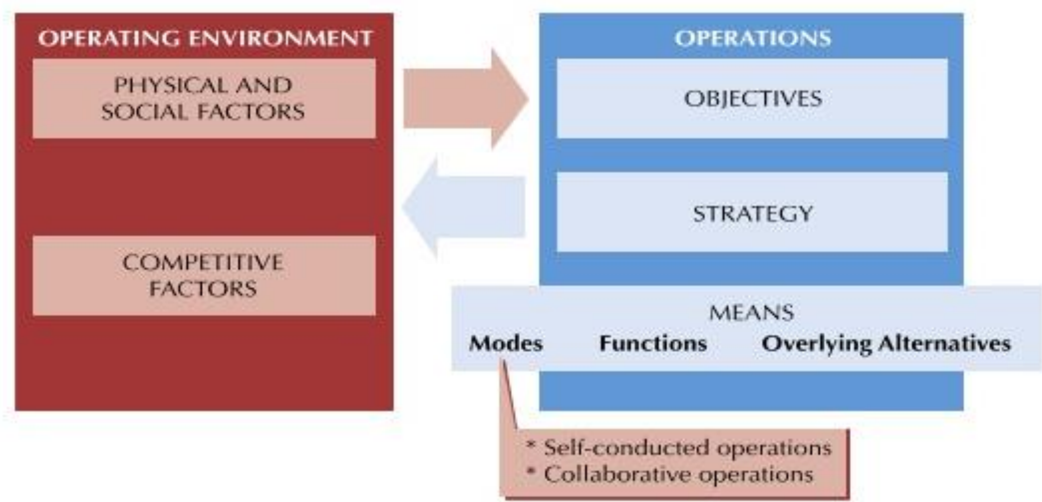
Introduction

A collaborative arrangement is a contractual arrangement that involves a joint operating activity.These arrangements involve two (or more) parties that meet both of the following requirements:

- They are active participants in the activity
- They are exposed to significant risks and rewards dependent on the commercial success of the activity

Firms collaborate because both domestically and internationally to spread costs. In other cases, it may enter into a collaborative arrangement to meet objectives specific to its foreign expansion strategies, i.e., diversifying geographically. Generally, collaborative arrangements include spreading and reducing costs, specializing in competencies, avoiding or counter competition, securing vital and horizontal links, and learning from other companies. Motives for collaborative arrangements specific to international business includegaining location-specific assets, overcoming legal constraints, diversifying geographically, and minimizing exposure to risky environments.

11.1 Factors Affecting Operating Modes in International Business



It starts with the objectives of the organization, as mentioned in the figure above. An organization can move to international because an organization is interested in sales expansion, resource acquisition, or risk minimization. Once the domestic market is getting saturated for the organization, objectives like sales expansion will come in handy for such an organization. Similarly, if an organization believes that resources are available at a cheaper cost in some other country, this could also serve as an objective for moving into the international market. Diversification leads to risk minimization, and this could be yet another objective for organizations in moving towards international markets.

When an organization moves to the international market, the operating environment plays a crucial role as these factors are beyond the organization's control. Therefore, an organization has to pay attention to all factors that are a part of the operating environment, influencing organization operations significantly. You will be reading about the same in the next unit. Organizations will keep changing their strategies depending upon which factor impacts the organization's operations.

An organization will adopt various measures to enter the international arena, like discussing the mode of entry. An organization can opt for any of the options mentioned in the figure, like licensing, franchising, turnkey operations, importing, and exporting. It depends on which mode is best going to suit the organization considering the product or service in which the organization deals.

There are various reasons why organizations opt for different modes of entry while moving into foreign markets.

1. Companies may find production abroad is cheaper than at home.

Let us take an example to get a better understanding of the same.

Importance of Mexico for American auto industry

The U.S. auto industry had imported $59.4 billion in parts from Mexico in 2018-19, according to U.S. government trade data. That included parts used in factories and those sold in auto parts stores and repair shops. As a result,Mexico is by far the largest foreign source of parts used by the industry. According to an estimate from the Centre for Automotive Research, about 16% of all auto parts used by U.S. assembly plants come from Mexico.

Automakers can't easily shift to other suppliers to avoid using parts from Mexico. Mexican parts suppliers specialize in low-cost, labor-intensive components, which don't make economic sense to build elsewhere. For example, 70% of wire harnesses, the collection of wires that carry power throughout a vehicle, come from Mexico. Few if any wire harnesses are made in the United States. Much of the rest of the harnesses arrive at the US-Mexican border from countries south of Mexico.

Finished cars and trucks also come into the United States from Mexico; about 2.7 million autos were imported from Mexico in 2018-19, worth $52 billion, according to the U.S. Commerce Department. That's nearly a million more autos than came from Japan, the No. 2 sources of auto imports.So this example clearly states that if production is cheaper in other countries, it is a viable option for companies to import such products rather than produce at a higher price.

2. When transportation costs are too high for moving goods or services internationally.

Let us consider an example to get an understanding of the same.

Indian exports were majorly hit by a 60% increase in freight charges in 2020.

Trade, both exports, and imports, had been badly impacted over in October 2020, after sea freight charges saw one of the highest ever increase of 60%. The development came after shipping companies hiked rates substantially. To make matters worse, exporterswere facing a massive shortage of containers due to lower imports over the last few months in 2020 due to pandemics. Due to such issues, companies opt for alternatives other than export/import for doing business in foreign markets.

3. When the company lacks domestic capacity.

This can be understood well with the help of an example.

Tyres import in India remained buoyant even during the lockdown in 2020.

According to data from the Directorate General of Commercial Intelligence and Statistics (DGCI&S), tyros worth $429 million were imported in FY19. In the first 11 months of FY20, a year that witnessed economic slowdown and reduced demand tyros worth $385 million were imported. The majority of the imports were from China. The country accounts for over 40 percent of imports regarding both truck and bus radial (TBR) and passenger car radial (PCR) tyres. In the case of tractor tyres, Chinese imports account for 75 percent of the total import. Here we can see that Indian manufacturers cannot full fill the demand available in the market.

4. When products & services need to be altered substantially to gain sufficient consumer demand abroad.

Let us take an example to get a better understanding of the same.

Despite tariff threat, Apple would keep its production in China

Apple had made a big bet on Foxconn and China and,as per estimation, could only move 5% to 7% of iPhone production to India or other countries in a best-case scenario by 2020. Foxconn's China factories are the "hearts and lungs of iPhone production globally, and that they were irreplaceable.As Apple has to come up with different price points in different geographic regions, production needs to be altered substantially to gain sufficient consumer demand.

5. When governments inhibit the import of foreign products.

Let us consider an example to get an understanding of the same.

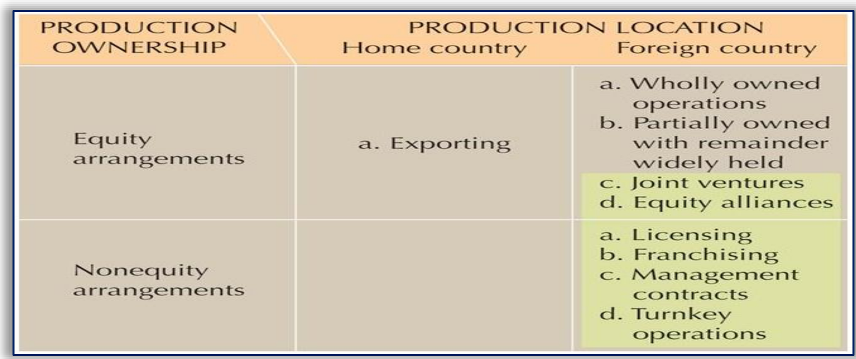
The Indian government restricted imports of toys, furniture, and sports goods in Aug 2020 to support domestic industry.

The Indian government was planning to impose licensing requirements to import furniture, toys, and sports goods. This move was aimed to boost local manufacturing in the country and encourage domestic production. This development came after the Indian government put restrictions on the import of colour television sets. In addition, earlier in July 2020, the government had imposed restrictions on the import of tyres used in cars, two-wheelers, and heavy vehicles to boost the domestic industry. Such type of scenarios also reflects protectionism by the policymakers of different economies.

6. When buyers prefer products originating from a particular country.

Here we can take an example of the perfume industry in France. Most of the country's consumers prefer to buy perfumes and deodorants originated from Paris, France.

11.2 Foreign Expansions: Alternative Operating Modes



PRODUCTION OWNERSHIP	PRODUCTION LOCATION Home country	Foreign country
Equity arrangements	a. Exporting	a. Wholly owned operations b. Partially owned with remainder widely held c. Joint ventures d. Equity alliances
Nonequity arrangements		a. Licensing b. Franchising c. Management contracts d. Turnkey operations

Let us consider the equity arrangements and see why companies opt for wholly owned operations in international markets.

There are few important reasons for wholly-owned foreign direct investment.

- Market failure
- Internalization theory
- Appropriability theory
- Freedom to pursue global objectives

Market failure

Collaboration is appealing as an entry strategy because it means a firm may reduce its liability of foreignness. Bu this work only if management can find an associate, knowledgeable about the host country at acceptable terms, or know too little about the entering company to entice to consign sufficient resources to a collaboration. In such instances company must control foreign activities within their management structures. Let us consider an example here.

DLF thought of bringing Swedish giant Ikea to India.

Realty major DLF was in talks with the world's largest home furnishings retailer, Ikea, to brought the Swedish brand into India in 2008. The developer was looking at a joint venture with Ikea on a sharing ratio. The proposed tie-up was in line with the Delhi-based builder's ambitious plans to bring in several foreign retail brands into India, especially in the luxury sector like Armani, Versace, Gucci, Salvatore Ferragamo, D&G etc. way back in 2008. But Ikea did not find the terms and conditions appropriate to continue with the deal. So later in 2013, Ikea entered the Indian market independently with 100% foreign direct investment.

Internationalization theory

Internationalization is control through the self-handling of operations. The concept comes from transactions cost theory, which holds that companies should seek the lower cost between self-handling of operations and contracting another party to do so for them.

Appropriability

The idea of denying rivals access to resources is called the appropriability theory. Companies are reluctant to transfer vital resources like capital, patents, trademarks, and management-know how to another organization for fear of their competitive position being undermined.

Freedom to pursue a global strategy

A wholly-owned foreign operation permits a company to participate more efficiently in a global strategy.

Acquisition Versus Greenfield

The advantage of acquiring an existing operation include:

- gaining vital resources that are otherwise hard to develop,
- making financing easier at times,
- adding no further capacity to the market
- avoiding start up problems

Companies may choose greenfield expansion if:

- host governments discourage acquisitions,
- it is easier to finance,
- the available acquisition is performing poorly,
- personnel in acquiring and acquired firms may not work well together.

This takes us to an exciting part of the unit that why do companies collaborate?

Motives for Collaborative Arrangements

OBJECTIVES OF INTERNATIONAL BUSINESS
- Sales expansion
- Resource acquisition
- Risk minimization

MOTIVES FOR COLLABORATIVE ARRANGEMENTS
General
- Spread and reduce costs
- Specialize in competencies
- Avoid or counter competition
- Secure vertical and horizontal links
- Learn from other companies

MOTIVES FOR COLLABORATIVE ARRANGEMENTS
Specific to International Business
- Gain location-specific assets
- Overcome legal constraints
- Diversify geographically
- Minimize exposure in risky environments

Sometimes it's cheaper to get another company to handle work, especially at a small volume, when the other company has excess capacity.Granting asset rights to another company can yield income when the asset does not fit the yielding company's strategic priority based on its competencies. By banding together, companies may move faster, raise profits, and fight larger competitors.Allying to gain vertical and horizontal links may enable companies to fill competency gaps, reduce costs, and deal more effectively with customers and suppliers.A company can improve its competence by learning from partners.

Local companies may more easily access competitively important country-specific knowledge to gain location-specific assets than foreign companies can. Collaborative arrangements in international markets are also made to overcome legal constraints.

11.3 Types of Collaborative Arrangements

Each operating mode brings both advantages and disadvantages.Companies have a wider choice of operating mode when they hold unique and needed capabilities.Terms differ for alliances depending on their purposes, whether they extend cooperation vertically or horizontally, and whether they involve competitors. Let us consider here different types of alliance that exists.

Types of Alliance

- Scale alliance
- Link alliance
- Vertical alliance
- Horizontal alliance

Scale allianceaims to provide efficiency for partners by pooling similar operations, such as airlines have done by combining their lounges.

Link alliancehelps firms to use their partner's complementary resources to expand into a new business. For example,Nokia did this to develop and market cellular phones.

Vertical alliance connects firms in different value chains, such as a food franchiser with a franchisee.

A horizontal alliance enables each partner to extend its product offerings on the same value chain level.

Over and above these alliances, companies' experience and assets in a foreign country influence their choices of operating mode when introducing new products or businesses. These are:

- Licensing
- Franchising
- Management Contracts
- Turnkey Operations
- Joint Ventures

Licensing

A business arrangement in which one company permits another company to manufacture its product for a specified payment.

Licensing agreements maybe

- exclusive or nonexclusive
- used for patents, copyrights, trademarks, and other intangible property

Let us consider an example for understanding licensing as a collaborative arrangement for international business.

Philips-Van Heusen was in talks for licensing out Calvin Klien and IZOD in India in 2019.

The U.S. clothing giant Philips-Van Heusen (PVH) had started negotiations with leading Indian apparel companies in 2019 to put its global designer brand, Calvin Klein, and premium lifestyle brand IZOD, on domestic shelves through a licensing arrangement.Philips-Van Heusen owns or licenses the ten most successful apparel and footwear brands in the U.S. This includes Calvin Klein, Van Heusen, IZOD, and G.H. Bass & Co, which are owned, and Arrow, Kenneth Cole, and Geoffrey Beene, licensed.

The designer brand Calvin Klein always enjoyed high recall in most Asian markets, including India, and Philips-Van Heusen, following the acquisition of Calvin Klein Inc in February 2003, had been exploring new business opportunities in the region.However, the U.S. giant's move to India as a market for IZOD could provide an interesting twist as the potential licensees might not be as keen on the brand as they were on Calvin Klein. In 2018, Philips-Van Heusen closed a licensing deal for IZOD in China, Hong Kong, and Taiwan with Hernpal International.

Philips-Van Heusen already has a licensing agreement with Indian major Madura Garments for the Van-Heusen brand in West Asia. In contrast, it has ties with the Sanjay Lalbhai-managed Arvind Mills in the sourcing side of the business.

Cross-licensing

Companies in various countries often exchange technology or other intangible property rather than compete on every product in every market; such an arrangement is known as cross-licensing.An example of the same is Google(U.S.) and Samsung (Korea) entering a cross-licensing agreement to access each other's current and future patents.

Franchising

It includes providing an intangible asset (usually a trademark) and a continual infusion of necessary assets.Many types of products, companies, and countries participate in franchising. Let us consider an example here for understanding the franchising concept well.

Domino's Pizza and Dunkin Donuts are operated by Master franchise Jubilant Food works in India.

Domino's Pizza, Inc., branded as Domino's, is an American multinational pizza restaurant chain founded in 1961. Global pizza powerhouse Domino's Pizza operated a total of 17,020 restaurants worldwide in 2019.In addition, the company runs a network of 1,126 Domino's Pizza restaurants across 264 cities in India, and Dunkin' Donuts has 50 stores across 12 cities in India.

Another example here can be seen of Burger King in India. In 2019, Inter Globe showed interest in being the master franchise of Burger King in India. Rahul Bhatia-controlled Inter Globe group was in advanced discussions to acquire the Burger King India franchise from private equity firm Ever stone Capital for about Rs 1,400 crore. The franchise rights for the fast-food chain were held by Singapore-based Ever stone Capital's QSR Asia Pte, a holding company for its restaurant investments in the region.

Challenges faced by franchisors:

These are:

- Inadequacy of local supplies may hamper global product uniformity.
- The more global standardization, the less acceptance in the foreign country.
- The more adjustment to the foreign country, the less the franchisor needed.

Management Contracts

Foreign management contracts are used primarily when the foreign company can manage better than the owners. An organization may pay for managerial assistance under a management contract when it believes another can manage its operation more efficiently than it can, usually because the contractor has industry-specific capabilities. For example, British Airport Authority has these for airport administration, and it manages some airports in the United States, Italy, and Australia.

Apeejay Surrendra Park Hotels Signed on 320 rooms under management contract in January 2021.

Apeejay Surrendra Park Hotels (ASPH) has four brands: The Park Hotels, The Park Collection, Zone by The Park, and Zone Connect. Zone Connect, a limited-service brand under its Zone by The Park portfolio, has been launched with four hotels, under the management contract, in Coimbatore, Goa, Port Blair, and Tirupathi. The hotels would open in the first half of 2021. Like most other hotel companies, ASPH has decided to go asset-light. Therefore, the ratio between owned and managed properties had been revised to 60:40; By 2024, the plan is to reverse it in favour of more managed properties.

Turnkey Operations

Turnkey operations are:

- Most commonly performed by industrialequipment, construction, and consulting companies,
- Often performed for a government agency.

Turnkey operations generally differ from other collaborations because they:

- May be so large,
- Depend on top-level governmental contracts,

- Are often in very remote areas.

Let us consider an example here for understanding turnkey operations as one type of collaborative arrangement.

In August 2020, Tata Projects completed 110 kilometres Surathani- Phuket transmission line project in Thailand.

Tata Projects Limited and its consortium partner had completed an important 110-km stretch of the 200-km Surathani-Phuket transmission line project in Thailand. This 500kV transmission line was an achievement since it passed through thick jungles and mountainous terrain. Tata Projects Limited provides turnkey end-to-end solutions to set up power generation plants, power transmission and distribution systems, fully integrated rail and metro systems, commercial buildings and airports, chemical process plants, water and waste water management solutions, complete mining and metal purification systems.

Joint Ventures

It is a strategy where two or more companies combine to form a new company to use the strengths of the partners to gain access to a new business. For example, Maruti-Suzuki in India can be seen. It is a business arrangement in which two or more parties agree to pool their resources to accomplish a specific task. This task can be a new project or any other business activity.

Joint ventures also create synergies and give the companies cost and benefit advantage. It can be formed because of different reasons to enter a new market or geography, to enter into a new business line altogether. Also, there are no separate governing bodies for joint ventures as they decided to enter into a new agreement. Let us consider an example for understanding it well.

Volvo and Uber had announced a $300 million joint venture to developed self-driving cars in 2016.

The partnership was meant to saw the Swedish-based carmaker, owned by China's Geely, and ride-hailing service Uber pool resources into initially developing the autonomous driving capabilities of its flagship XC90 SUV. The investment was roughly shared equally by the two companies.Uber was supposed to purchase Volvos and then installed its driverless control system for the specific needs of its ride-hailing service. Volvo was considered to use the exact vehicle for its autonomous driving project based on a plan that envisaged having a driver in the car.

As we have got some clarity with the help of the above example, let us now consider a small case of the Indian company Tata and AirAsia from Malaysia to understand the concept of joint venture well

Joint venture between Tata (An Indian multinational conglomerate) and AirAsia (Malaysia).

Tata group, the pioneer of commercial air travel in India, was set to re-enter the country's aviation sector in partnership with Malaysia's AirAsia, Asia's biggest budget carrier, and Telestra Trade place in early 2013.Tatas Sons thought of being the minority investor with a 30 percent stake, and Telestra Trade place would hold a 21 percent stake. At the same time, the Malaysian airline would have operational control with a 49 percent stake. These were the joint venture partners, which expected to begin operations by the fourth quarter of the year 2013.

AirAsia was a Malaysian low-cost airline headquartered near Kuala Lumpur, Malaysia. It was the largest airline in Malaysia by fleet size and destinations. AirAsia Group operated scheduled domestic and international flights to more than 165 destinations spanning 25 countries.AirAsia had carefully evaluated developments in India over the last few years, and the organization strongly believed that the environment in 2013 was perfect for introducingtheir low fares.

The Tata-AirAsia deal was in line with the estimate of industry experts that the policy change would lead to equity deals in 2-3 existing airlines and 1-2 fresh start-ups. This was expected to enhance competition, expand the spread of air connectivity to tier 3-4 cities, and would bring down airfares for the Indian passenger. In addition, the short notice start-up in Air Asia's joint venture - including 30% shareholder Tata - had surprised competitors and could gain the airline the advantage of the early mover at that time.

AirAsia's experience across the region could lead to the introduction of new norms into the Indian market. Still,the speedy introduction of changes to the five years/20 aircraft rule would be necessary to secure the airline's success in the medium term. In addition,AirAsia's proposed pricing strategy was unlikely to allow the carrier to achieve breakeven within four months as targeted during the launch of the operations in India.

AirAsia India, which launched operations in June 2014,was set up as a tripartite joint venture between Tata Sons (who owned 30 percent then), Telestra Trade place (21 percent), and AirAsia Berhad of Malaysia (49 percent).Over the last 18 months, Tata Sons have been increasing its stake in the airline by buying Telestra Trade place. With these developments, Tata Sons consolidated its position in the Indian aviation industry.

Budget carrier AirAsia India announced the induction of 20th aircraft in its fleet, making it eligible to fly on international routes in 2018.The delivery of the 20th Airbus A320 plane to AirAsia helped it launch flight services in international markets. Airlines were earlier required to fly for at least five years on domestic routes and have a fleet of 20 aircraft before being allowed to fly international.However, with new policy measures in 2017-18, organizations could operate in overseas markets just by having 20 aircraft in the fleet or 20 percent of total capacity (in terms of an average number of seats on all departures put together).

In 2020, the environment became more troublesome for the budget carrier AirAsia. In May 2020, this budget airline had a 7.8 percent share in the Indian market and was placed in the fifth position. However, AirAsia has been facing a severe downhill as per the disruptions that COVID-19 has caused.After shutting down operations in Japan, Malaysian firms evaluated investment in Indian budget airline that had never reported an annual net profit. AirAsia India was expected to get breakeven as their strategy in the first four months of the operations, but that did not happen. AirAsia's losses widened to ₹332 crore in the June quarter of 2020, mainly due to the lockdown.

AirAsia's businesses in Japan and India were draining cash, causing the group much financial stress. Cost containment and reducing cash burns remained key priorities evident by the closure of AirAsia Japan and an ongoing review of their investment in AirAsia India in 2020. A detailed network and fleet optimization strategy was implemented across the network, putting the right foundations for a sustainable and viable future. AirAsia continually reviewedits network to fly the most popular and profitable routes in the ASEAN region.

In December 2020, Tata Group Paid AirAsia around $38million (£28m) for the increased stake in the AirAsia India joint venture, which began in 2014. The deal kept the Indian conglomerate firmly in command of the budget carrier. AirAsia had been looking to reduce its cash-burn, and its Japan unit filed for bankruptcy in November 2020.AirAsia India had struggled to make money in a market considered one of the world's toughest due to high fuel taxes and fierce competition. It said, "India is a non-core market," and the transaction would allow it to concentrate on recovery in its key markets of Malaysia, Thailand, Indonesia, and the Philippines.

So, just starting a joint venture does not guarantee success to international companies. Organizations are supposed to evaluate the other important factors that impact their nature of business the most.

Equity Alliance

An equity alliance is a strategic alliance where one of the partners in the alliance purchases equity in the other partner firm. These equity investments are typically made through a direct purchase of the shares in the firm via a private placement.

Types of Collaborative Arrangements

11.4 The Reasons for Failure of Collaborative Arrangements

The reasons that lead to the failure of collaborative arrangements are:

- The relative importance to partners
- Divergent objectives
- Control problems
- Comparative contributions and appropriations
- Difference in culture

Relative Importance:

Partners may give uneven management attention to a collaborative arrangement, which often happens due to their disparate sizes. Let us consider an example to understand it well.

Germany's Boehringer Mannheim had filed an action against IGENInternational in 1997.

Germany's Boehringer Mannheim had filed an action against IGENInternational in the U.S. District Court for the southern district of Indiana in 1997, followed by disagreements between the two companies concerning the interpretation of several provisions in their contract concerning the strategic collaboration they entered into in 1991.

An amount of $300 million was invested from 1991 to 1997; B.M. and IGEN have been developing immunodiagnostic systems based on the latter's patented electrochemiluminescence technology used in Elecsys systems expected to improve efficiency in laboratory testing. During that period, B.M. had invested more than $300 million to develop the Elecsys systems into a marketable product.

IGEN had partnered with larger companies to develop Origen-based products. One of those agreements was reached in 1992 with the German company Boehringer Mannheim, which Roche acquired in 1998.Under the deal, Boehringer gained rights to market Origen-based products to hospitals, clinical reference laboratories, and blood banks. In addition, IGEN was to receive 9 percent royalty on sales of the products.But in its suit, filed in September 1997, IGEN claimed Boehringer sold Origen-based equipment directly to doctors, a market not covered by the agreement. It also claimed the German company paid it only half of the royalties IGEN could have collected.

In January 2003, a federal jury ordered the Swiss company Roche Holding AG that acquired German company, Boehringer Mannheim, to pay IGEN International $505 million in damages for violating the terms of a licensing agreement over an IGEN biological testing technology.

IGEN got the amount, but it took more than six years to get the result. Smaller companies sometimes do not have the funds to prolong the case in court and give up eventually.

Divergent Objectives

As partners' capabilities and strategies evolve, their collaborative objectives may change. In addition, partners' initial complimentary objectives may evolve differently due to competitive forces and product dynamics. Thus, a partner may no longer perceive collaboration to be in the best interest. Let us consider an example here.

Ford-Mahindra deal called off due to high costs and pandemic impact in January 2021.

Automakers Ford and Mahindra & Mahindra have called off their deal to form a joint venture company to acquire the former's India business, citing higher than the expected capital requirement and changed business economics due to the impact of the coronavirus pandemic.The deal did not make economic sense after the capital that both companies had to get enhanced due to Covid-19-related issues and other global effects.

The objectives were not being met, and the capital required for the business was much higher; hence both organizationsstarted looking at different ways of collaborating.

Control Problems

Sharing assets with another company may generate confusion over control. Such confusion is rife with grey areas and may cause anxiety among employees.In collaborative arrangements, even though control is ceded to one of the partners, both may be held responsible for problems, as can be seen from this example, in a joint venture to make baby formula between the Israeli company Remedia and the German firm Humana Milchunion.

Humana Milchunion's removal of Vitamin B1 from the formula concentrate lead to the deaths of three infants. Furthermore, Remedia was jointly responsible even though it had not been notified of the removal. So, such issues lead to the failure of collaborative arrangements.

Comparative Contributions & Appropriations

If one partner perceives that the other contributes too little or takes out too much, the collaboration may weaken. To counteract this appropriability, the suspicious firm may withhold information, eventually weakening the operation.There are many examples of companies going it alone after they no longer needed their partners, particularly if the purpose of the collaboration was to gain knowledge.

Difference in Culture

Differences in country and company cultures may cause one partner to be satisfied and the other dissatisfied. For example,a joint venture between Japan's ANA and Malaysia AirAsia broke up as the former wished to emphasize its culture of meticulous service. In contrast,the latter had a culture of cutting costs.

11.5 Ways of Managing Collaborative Operations

The different ways of managing collaborative operations are:

- Fitting modes to a country difference
- Finding and evaluating partners
- Negotiating agreements
- Controlling through contracts and trust
- Evaluating continually
- Adjusting the internal organization

Companies should make their highest commitments in operating modes where markets are most attractive and best fit their competencies and strategies.Partner pairing should depend on a mutual assessment of each other's resources, motivation, and compatibility. For such evaluation's

companies can use country attractiveness-company strength matrix. This matrix helps an organization know which type of collaborative arrangement would be ideal for a particular geographic region.

Country Attractiveness-Company Strength Matrix

In technology agreements,

- Sellers do not want to give information before assuring an agreement can be reached,
- Buyers want to evaluate information before committing to an agreement,
- The contract terms may be considered proprietary.

For example, in some countries, governmental agencies must approve licensing contracts, which consult their counterparts in other countries about similar agreements to improve their negotiating position.Thus, although both trust and contracts have control limitations, some provisions should be included in any collaborative agreement.

When collaborating with another company, managers must:

- Continue to monitor performance,
- Assess whether to change the form of operations,
- Develop competency in managing a portfolio of collaborations.

The evolution to a different operating mode may:

- Be the result of experience,
- Create organizational tensions

Summary

A collaborative arrangement is a contractual arrangement that involves a joint operating activity.

There are various reasons why organizations opt for different modes of entry while moving into foreign markets.

- Companies may find production abroad is cheaper than at home.
- When transportation costs are too high for moving goods or services internationally.
- When company lacks domestic capacity.
- When products & services need to be altered substantially to gain sufficient consumer demand abroad.
- When governments inhibit the import of foreign products.

- When buyers prefer products originating from a particular country.

Licensing is a business arrangement in which one company permits another company to manufacture its product for a specified payment.

Companies in various countries often exchange technology or other intangible property rather than compete on every product in every market; such an arrangement is known as cross-licensing.

A joint venture is a strategy where two or more companies combine to form a new company to use the strengths of the partners to gain access to a new business.

An equity alliance is a strategic alliance where one of the partners in the alliance purchases equity in the other partner firm.

Keywords

Appropriability:The idea of denying rivals access to resources is called the appropriability theory. Companies are reluctant to transfer vital resources like capital, patents, trademarks, and management-know how to another organization for fear of their competitive position being undermined.

Scale alliance: Itaims to provide efficiency for partners by pooling similar operations, such as airlines have done by combining their lounges.

Link alliance: Ithelps firms use their partner's complementary resources to expand into a new business.

Vertical alliance: It connects firms in different value chains, such as a food franchiser with a franchisee.

Horizontal alliance: It enables each partner to extend its product offerings on the same value chain level.

Licensing: It is a business arrangement in which one company permits another company to manufacture its product for a specified payment.

Joint venture: It is a strategy where two or more companies combine to form a new company to use the strengths of the partners to gain access to a new business.

Equity alliance: It is a strategic alliance where one of the partners in the alliance purchases equity in the other partner firm.

Self Assessment

1. Which of the following is the LEAST likely reason consumers would prefer domestically made products over imports?

A. a belief that imports are subsidized
B. feelings of national pride and sentiment
C. negative associations with products from certain countries
D. concerns that parts will be difficult to obtain for foreign products

2. A U.S. firm plans to shift from exporting to production in China to serve the Chinese market. Which of the following statements would best explain this decision?

A. China's currency is appreciating relative to the U.S. dollar.
B. The firm is nearing capacity utilization in its U.S. plant.
C. The company need not alter its products for the Chinese market.
D. Transportation costs have become low relative to production costs.

3. Coca-Cola collaborates extensively abroad, but it refuses collaboration that might imperil control of its core competency. As a result, which of the following is NOT one of its international collaborative forms?

A. sharing ownership in the production of its secret formula concentrate
B. using franchisers to bottle, sell, and deliver Coke beverages
C. licensing Coke's trademark for use on products in which it lacks skills
D. forming joint ventures with companies that provide supplies for Coke products

4. Small economies are sometimes less successful than large countries in attracting FDI by raising import restrictions. What is the most likely reason for this?

A. Large economies impose higher trade restrictions.
B. Transportation costs are generally higher in small economies.
C. People in small economies are more nationalistic in their purchases.
D. Small economies frequently lack sufficient markets for large-scale production.

5. A U.S. firm owns 100% of its production facility in Brazil; thus, it is most likely using a(n) ________ strategy.
A. comprehensive ownership
B. vertical integration
C. appropriability
D. internalization

6. Appropriability theory refers to ________.
A. denying rivals access to competitive resources such as management know-how
B. categorizing the appropriateness of a firm's foreign investments in terms of host country objectives
C. explaining an investing firm's choice of partner in a joint venture
D. predicting the general pattern of direct investment locations

7. A greenfield investment is another name for a company's decision to ________.
A. acquire an interest in an existing foreign operation
B. implement sustainable marketing practices
C. construct a new facility in a foreign market
D. build a facility for a local company

8. A company that makes a foreign investment largely to acquire knowledge is most likely to use ________ as a means of expansion.
A. a greenfield investment
B. internalization
C. an acquisition
D. a licensing agreement

9. In which of the following situations would Company X most likely seek a collaborative arrangement with Company Z in which Company Z would handle work for Company X?
A. Company X has excess capacity.
B. Fixed costs for the work are high, and Company X has large volumes of work.
C. Company X is inexperienced in outsourcing work.
D. Fixed costs for the work are high, and Company X has small volumes of work.

10. Which of the following is an argument for using a collaborative agreement?
A. to prevent problems caused by minority shareholders
B. to preserve a concentration strategy
C. to secure vertical and horizontal links
D. to maintain better control

11. The more a company engages in international collaborative arrangements as opposed to wholly-owned foreign operations, the more it is likely to ________.
A. decrease its exposure to political risk
B. increase its control over foreign operations
C. learn rapidly about foreign environments
D. protect its core assets

12. Coca-Cola has collaborative arrangements whereby it produces a concentrate that it sells to other companies to bottle its drinks. Which of the following terms best describes this type of arrangement?
A. vertical alliance
B. horizontal alliance
C. link alliance
D. scale alliance

13. Chrysler granted South East Motor (a company in China) rights to produce its Grand Voyager minivan for sale in China in exchange for a fee. This is an example of a ________.
A. licensing agreement
B. bargaining school arrangement
C. technology appropriation
D. turnkey operation

14. Collaborative agreements allow companies to specialize more in those activities that best fit their competencies.

A. True

B. False

15. An advantage of collaborative agreements is the ability to spread faster geographically.

A. True

B. False

16. Which of the following is not a reason for the failure of collaborative arrangements?

A. Divergent Objectives

B. Difference in Culture

C. Greenfield investment

D. Comparative contributions and appropriations

17) Sharing assets with another company may generate confusion over _______ between the management of the organizations.

A. Objectives

B. Control

C. turnkey operations

D. None of these

Answer for self Assessment

1.	A	2.	B	3.	A	4.	D	5.	D
6.	A	7.	C	8.	C	9.	D	10.	C
11.	A	12.	A	13.	A	14.	A	15.	A
16.	C	17.	B						

Review Questions

1. In brief,discuss how transportation, trade restrictions, domestic capacity, and country-of-origin effect companies' decisions about modes of operating internationally.

2. There are two ways companies can invest in a foreign country. They can either acquire an interest in an existing operation or construct new facilities. In a short essay, describe the advantages and disadvantages of each alternative.

3. According to the appropriability theory and the internalization theory, why would companies control their foreign operations?

4. What do you understand by an equity alliance?

5. What motives do businesses have for entering into collaborative arrangements? What are some of the problems associated with collaborative arrangements?

6. What are the various types of collaborative arrangement options available to international businesses?

7. What is the difference between licensing and cross-licensing?

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Unit 12: International Business Diplomacy

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Objectives

After studying this unit, you should be able to

- illustrate international business negotiations among organizations
- analyze the ways of managing the international business negotiations
- demonstrate the issues related to asset protection in international business operations
- illustrate the multilateral sentiments among various geographic region across the globe

Introduction

Communication in negotiation is how negotiators can achieve objectives, build relationships, and resolve disputes. Most negotiators know that it is the most important tool one can have for successful negotiations. Communication becomes even more important when negotiations include counterparts that are from different cultures.In cross-cultural negotiations with international business negotiation, we need to understand how culture consists of socially transmitted behavior patterns, attitudes, norms, and values of a given community, whether a nation, an ethnic group, or even an organization. Understanding a foreign counterpart's culture is a lot like peeling an onion, as we interpret behavior to reveal attitudes, which reflect norms, which are founded on values.

Negotiating communication has created new challenges, as business becomes global, and the distance between the two parties does not allow to negotiate fully – to take full advantage of the bargaining power remotely. The use of innovation can be beneficial not only to support the negotiation process but also in the preparation phase of the negotiations. To properly prepare for negotiations is need to form an effective negotiating team whose analytical work and skills could help to achieve the highest outcome of the negotiations. This is particularly important in the preparation and in the course of intercultural negotiations, which require an understanding of other cultures, other languages, possession of legal knowledge, knowledge of the negotiation context, etc. In preparation for the negotiation phase is needed to know the best way possible about the other side of the negotiation. Knowing the technical communication capabilities of the other negotiation side it is possible to prepare effective negotiation support tools. Negotiation success often depends on the effectiveness of the preparation - the better it will be known the other side of the negotiation and negotiation context, the better results will be achieved.

12.1 International Business Negotiation

It is defined as the deliberate interaction of two or more social units (at least one of them a business entity), originating from different nations, that are attempting to define or redefine their interdependence in a business matter.This includes company-company, company-government, and solely interpersonal interactions over business matters such as sales, licensing joint ventures, and acquisitions.

Process of Negotiation

Negotiations can be broken down into twothree stages:

- the pre-negotiation phase,
- negotiation phase, and
- the post–negotiation phase.

Pre- negotiation phase

It involves preparation and planning; it is the most important step in negotiation. It consists of interactions, such as building trust and relationships, and the task-related behaviours which focus on the preferences related to various alternatives.

During the preparatory stage, each party must lay down precisely the purpose of negotiations, the party's relative strength and weaknesses, its minimum demand and maximum concessions, the strategy and tactics to be used, possible options for solutions, and their costs for both parties, and its opening positions. The entire list of concessions to be made should be prioritized and translated into money terms. It only by knows the real value of concession in both the short and long term that its full impact on the issues being negotiated can be assessed.

Negotiation Phase

It involves face-to-face interaction, methods of persuasion, and the use of tactics. At this stage, negotiators explore the differences in preferences and expectations related to developing an agreement. It includes:

- Price Issue
- Timing
- Dispute Settlement

After the opening positions are known each party should start to make minor concessions to keep the negotiation process moving while addressing issues of joint interest.After covering all of the non-price issues, the exporter can shift the discussions in the final phase of the talks to financial matches having a bearing on the price quotation.

This is the time to agree on issues such as credit terms, payment schedules, currencies of payment, insurance, commission rates, warehousing costs, costs of replacing damaged goods, and so on. Agreement reached on these points constitutes the price package.

Timing in negotiation is crucial particularly the questions when to make concessions, when to ask for a recess, and when to start agreeing.

In dispute settlement, both exporter and importer should agree to a suitable arbitration mechanism in case of any dispute arising after signing of contract agreement Laws of which country will be applicable and also the place of jurisdiction should be clearly stated in the contract agreement.

Post-Negotiation Phase

It relates to concessions, compromises, evaluating the agreement, and following-up. These stages are often done concurrently. The negotiation process is dynamic, involving a variety of factors related to potential negotiation outcomes.

International business negotiations are typically more complicated and difficult to assess than the negotiations taking place between negotiators from the same culture. This is because the values of the negotiators are different. Negotiators have unique perspectives on negotiations leading to different styles.

Other external influences such as international law, exchange rates, and economic growth also increase the complexity of negotiations. International business negotiators need to understand each other's values so that they can adapt their negotiating approaches to emerging situations.

Culture & Negotiations

Culture consists of patterns, explicit and implicit, of behaviour acquired and transmitted by symbols including their embodiment in artifacts. The essential core of culture consists of traditional ideas and values. Cultural systems may be considered as products of action or as conditioning further action.

Culture provides the context for negotiation because it takes place within the framework of a culture's institutions and is influenced by its norms and values. Culture is a key factor affecting negotiation processes and outcomes negotiation practices differ from culture to culture.

Culture provides the "negotiating style" – the way persons from different cultures conduct themselves in negotiating activities. Culture determines the way people perceive and approach the negotiating process. They have specific perspectives on power, time, risk, communication, and complexity. Individualist negotiators tend to engage in coercive or competitive behaviour and arguments whereas collectivist negotiators emphasize relationships and problem-solving.

Cultural Values on International Business Negotiation Process

International Business Negotiation Process	Impact of Cultures
Goal	Thai, Chinese, and Japanese negotiators value long-term relationships. Western negotiations aim at signing a contract.
Protocol	The degree of formality in a negotiation can vary from culture to culture. Thais value etiquette and respectful manners. English and German negotiators are very formal and highly concerned with proper protocol.
Communication	Thais tend to speak softly and use almost no gestures, and prefer indirect language. Americans are direct and prefer a straightforward presentations with nminimum of game playing.
Time	American are sensitive to time. They view it as a limited resource that must not be wasted. Japanese regard time as long duration, spending time to counterparts. Thais have a very relaxed attitude to time and scheduling
Risk Propensity	Japanese prefer predictable situations, being strict to the rules. Thais are more flexible to the rules, and accepting changes.
Group versus Individuals	In decision making, a more collective culture places emphasis on group priority. An individual-oriented culture is more independent and assertive. Thai culture is group-oriented, but hierarchical; decisions are made by the top managers, Japanese negotiators rely on consensus.
Nature of Agreements	Thais generally respect contracts, but personal commitment has more value. Germans are detail-oriented and prefer specific provisions.

The cultural differences consistently influence international business negotiations. This indicates that even though some universal characteristics of international business negotiation are generally recognized, negotiators from specific cultures view negotiations as a particular style. They emphasize different priorities of goals, the negotiation process, and expected outcomes. Understanding the influence of culture in negotiation reduces confusion and misinterpretations in the process. Negotiators need to be aware of such cultural differences and become well prepared for them. Let us understand the concept of negotiation with the help of an example.

When Ikea entered India in 2012-13, it was supposed to comply with rules but before that negotiations took place between the company and Indian policymakers

In 2012-13, after nearly four months of negotiations with the Indian government over a controversial one-third local sourcing of merchandise norm, IKEA Group had finally told the government that it would fully comply with the country's newly diluted single-brand retailing regulations but said it would maintain two separate companies in India, One for sourcing and the other for local retailing which would have foreign investment. In a revised application to the department of industrial policy and promotion, IKEA said activities such as range development, sourcing, and retail functions would be conducted by appropriate separate entities within the IKEA group which have the necessary expertise to carry out such functions.

Ikea also said it would ensure compliance with regards to the statuary 30% sourcing from India and preferably from local small and medium vendors as mandated by aclarification from the government.The government clarified that the sourcing requirements would be based on the total value of the goods purchased locally over an average period of five years and not a day one requirement.

The Swedish retailer had initially sought a 10-year moratorium. Ikea's original proposal was clouded due to a single brand criterion that mandates companies seeking to own in excess of 51% local subsidiaries must source 30% of the wares they sell from small and medium local vendors.Ikea argued that the vendors they engage in India are bound to grow in size as the company scales up business in the country.Ikea did ask the DIPP to allow it to continue sourcing from the small vendors even after the SME's total investment crosses the current ceiling of $1 million.The clause warranted frequent changing of vendors as their investment passes the $1-million threshold and it would impact IKEA's supply chain, product quality, and costs, the retailer told the DIPP that clears FDI in single-brand retailing.

In its application, IKEA had also explained that it would only sell branded Swedish food, chocolate packages of gravy, and various Scandinavian biscuits and crackers, among others.

12.2 Asset Protection

Asset protection is the concept of and strategies for guarding one's wealth against taxation, seizure, or other losses.Asset protection helps legally insulate assets without engaging in the illegal practices of concealment (hiding of the assets), contempt, fraudulent transfer, tax evasion, or bankruptcy fraud.

The global and technologically interconnected nature of today's business environment exposes companies to a wide array of evolving risks. Principles-based disclosure regime, rooted in materiality, recognizes that a variety of new risks may arise over time, and each of these risks may affect different companies in different ways.

The increased reliance on technology, coupled with a shift in the composition of many companies' assets from traditional brick-and-mortar assets towards intangible ones, may expose companies to material risks of theft of proprietary technology and other intellectual property, including technical data, business processes, data sets or other sensitive information.

While many companies may face these types of risks, companies that conduct business in certain foreign jurisdictions, house technology, data, and intellectual property abroad, or license technology to joint ventures with foreign partners may have more significant exposure.

Importance of Asset Protection

The goal of a comprehensive asset-protection plan is to prevent or significantly reduce risk by insulating business and personal assets from the claims of creditors.An asset-protection plan employs legal strategies, put in place before a lawsuit or claim arises, that can deter a potential claimant or help prevent the seizure of assets after a judgment.

Asset Protection Strategies

It includes:

- Corporations
- General Partnership
- Trusts

Corporations

There are several types of corporations that are used to protect assets: business or C Corporation, S corporations, and limited liability companies (LLCs). The appeal of corporations as an asset-protection tool lies in the limited liability provided to its officers, directors, and shareholders (principals).

Corporate principals have no personal liability for corporate debts, breaches of contract, or personal injuries to third parties caused by the corporation, employees, or agents. While the corporation may be liable or responsible, a creditor is limited to pursuing only corporate assets to satisfy a claim.

General Partnership

As an asset-protection tool, a general partnership is one of the leastuseful arrangements because each partner is personally liable for all of the debts of the partnership, including debts incurred by other partners on behalf of the partnership. Any single partner can act on behalf of the other partners with or without their knowledge and consent.

Trusts

A trust is an agreement between the person creating the trust (referred to as the settler, trustor, or grantor) and the person responsible for managing the assets of the trust (the trustee). The trust provides that the grantor will transfer certain assets to the trustee, who will hold and manage the assets in trust for the benefit of another person, called the beneficiary.

Let us consider an example for understanding it well.

Nike’s case against Adidas in 2006

In the year 2006, Nike Inc filed a patent infringement lawsuit against Adidas-Salomon AG, claiming its archrival makes shoes using elements of Nike's SHOX cushioning technology. Beaverton-based Nike alleged that the new Kevin Garnett signature shoe made by Adidas and its A3 shoes wereamong the footwear that violated the Nike patent. Despite Nike's patent protection, Adidas had built shoes that used Nike's technology.

Asset protection issues are not only associated with the organization but also with the governments of different economies as well. We can see the same with the help of an example.

During the Pandemic in 2020, India and South Africa seek a waiver in global IPR laws for easy access to medical products

In the joint proposal, they sought a waiver from obligations of members to implement or apply provisions related to copyright or related acts, industrial designs, patents, and protection of Undisclosed Information in the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement). They also pushed for an exemption from a clause that provides the legal basis for WTO members to grant special compulsory licenses exclusively for the production and export of affordable generic medicines to other members that cannot domestically produce the needed medicines in sufficient quantities for their patients.

Let consider another example from the corporate world of two multinational organizations Samsung and Ericsson

: Samsung was sued by Ericsson over IPR licensing issues in December 2020.

The Samsung Group is a South Korean multinational conglomerate headquartered in Samsung Town, Seoul. It comprises numerous affiliated businesses, most of them united under the *Samsung* brand, and is the largest South Korean *chaebol* (business conglomerate).

Ericsson is a Swedish multinational networking and telecommunications company headquartered in Stockholm. The company offers services, software, and infrastructure in information and communications technology for telecommunications operators, traditional telecommunications and Internet Protocol (IP) networking equipment, mobile and fixed broadband, operations and business support services, cable television, IPTV, video systems, and an extensive services operation.

Ericsson had sued Samsung over patent licensing issues in a Texas court.Samsung allegedly violated the Fair, Reasonable, and Non-Discriminatory (FRAND) terms and conditions of the contract.Many common technological standards, such as Wi-Fi and Bluetooth, are protected by patents held by specific companies. These are used by other companies under Fair, Reasonable, and Non-Discriminatory terms (FRAND). It allows manufacturers to use these common technologies owned by certain companies by obtaining licenses. Though the Swedish giant had filed a suit against Samsung its financial effect was felt more by Ericsson itself.Ericsson also said that the lawsuit could cost them about Rs 1,300 crores per quarter from 2021. Since the company relies heavily on its commissions from the patents it holds, so it is obvious if this case continues that is going to take a hit.

Let us now consider an example from an emerging market like India.

: ITC and Nestle tussle over the expression Magic Masala.

ITC Ltd is one of India's foremost private sector companies. ITC has a diversified presence in cigarettes, hotels, paperboards &specialty papers, packaging, agri-business, packaged foods &confectionery, information technology, branded apparel, personal care, stationery, safety matches, and other FMCG products.

Founded in 1866, Nestlé is the largest food and beverage company in the world. Initially, the company sold only infant cereal but they quickly diversified to include a variety of products including chocolate, coffee, soup, yogurt, water, and frozen foods in their portfolio.

'Maggi' and 'Sun feast Yi pee' noodles are the two most famous brands of Nestle and ITC, respectively.

The suit was filed by ITC ("***Plaintiff***"), in 2010 to claim that Nestle ("***Defendant***"), a pioneer in the instant noodles category, has been using the expression "*Magical Masala*" for its instant noodles brand Maggi since 2013 and so had been passing off their product, as against the brand Sun feast Yippee! which had adopted the same expression in the year 2010.

The term '*Magic Masala'* as used by Plaintiff, individually and collectively is common to the trade and thus, laudatory and descriptive and cannot be subjected to any proprietary right by any member of the trade to the exclusion of others. The court expressed that the mark would have been held as a distinctive mark and could, in turn, qualify for protection and monopoly, if it had been able to show that its products or services had been in commercial use for a long and uninterrupted period, to the exclusion of others, thus acquiring secondary significance and superior 'sub-brand status, such that consumers associate the term with goods originating from them exclusively and no-one else.

If the plaintiff had filed a trademark application to register the expression 'Magic Masala' as a wordmark, it would have been rejected by the Indian Trade Mark Registry under Section 9 of the Trade Marks Act, 1999 (*which prohibits registering generic names*). The expression 'Masala' signifies a mixture of ground spices used in Indian cooking and as such this laudatory epithet cannot be accorded monopoly or protection;The court also observed that Nestle was the prior user and adopter of the expression 'Magic' (based on the evidence adduced) and the expression 'Magic Masala' was first adopted by Lays for their potato chips.

Nestle argued that both the expressions "Magic Masala" and "Magical Masala" have been used both by the plaintiff and the defendant as a flavor descriptor and therefore, are incapable of being appropriated by the plaintiff alone and thus, cannot be monopolized by any trader. So such types of issues keep on arising when international firms compete against each other in the global market.

12.3 Multilateralism

It is a process of organizing relations between groups of three or more states.It is considered to comprise certain qualitative elements or principles that shape the character of the arrangement or institution. Let us consider an example to understand this concept well.

The United States and South East Asia ties beyond 2020

Many Southeast Asian decision-makers saw the United States as disengaging from the strategically vital crossroads of Asia and rapidly losing ground to China.The COVID-19 pandemic would likely

reinforce gains in China's relative influence. Southeast Asian leaders were focused above all other priorities on economic recovery and look to China to drive growth. And while Southeast Asian governments worried quietly about China's growing sway, most worried even more about US-China strategic rivalry.Still, however careful their public remarks, Southeast Asian governments don't want to be left on their own with China.

A reinvigorated US diplomatic strategy, one that encompasses competition with China while valuing Southeast Asian partnerships in their own right, would be welcomed across the region. Working better with the grain of the region was essential. Washington understandably wanted to win Southeast Asia to its side in the contest for influence with China. But with most of Southeast Asia clinging determinedly to strategic autonomy, a more realistic strategy, would be to help the region stay safely anchored in the middle.

Views of the United States in Southeast Asia were as diverse as one would expect in a region in which Cambodia, at one end of the spectrum, has tied itself ever more closely to China and Vietnam, at the other, saw its relationship with Washington as essential to counter a more aggressive and unilateral China.Centre for Strategic and International Studies survey found that China was viewed as "much more influential" than the United States in terms of economic power and influence. Regional elites saw this gap continues to grow in China's favour. In the Institute of Southeast Asian Studies ISEAS survey, nearly 80 percent of respondents saw China as the most economically influential country in the region.

The ISEAS survey also showed a decline in perceptions of the United States as the region's most strategically influential country, from 30.5 percent in 2019 to 26.7 percent in 2020. And strong majorities in both the 2020 and 2019 ISEAs surveys believed US engagement with Southeast Asia was declining under the Trump Administration.

Southeast Asia gets sustained (if largely self-interested) attention from Beijing. China had the advantage of geographic proximity. It was building ever-deeper connections with the region through Belt and Road Initiative (BRI) road, rail, port, and digital infrastructure investments. Southeast Asia was deeply integrated into China-cantered value chains, both for inputs and final products. Pre-COVID, Chinese investment flows into Southeast Asia were growing rapidly and China was the region's largest source of tourists and a major supplier of labour.

The United States had long-standing and significant investment and trade links to Southeast Asia. But when Southeast Asian governments think about future opportunities, they tend to look to China, especially as they seek to rescue economies damaged by COVID-19.The International Monetary Fund expected Southeast Asia's economy to decline by 3.4 percent in 2020. Poverty was rising. Unemployment and underemployment have increased, especially in the large informal sector. Many small businesses would never re-open. A bounce-back was forecasted for 2021, but recovery won't be even across the region and the downside risks would remain considerable well into the future.

The Trump Administration's decision to align declaratory policy on the South China Sea with the 2016 South China Sea arbitration ruling had helped re-focus attention on the illegitimacy of China's sweeping maritime claims.The United States also stepped up its maritime presence in Southeast Asia and was exercising more with like-minded countries (although some Southeast Asian countries worried about the risk of a US-China clash). Support for regional coast guards had increased.

The Trump administration declassified its strategy to ensure continued dominance over China, which focused on accelerating India's rise as a counterweight to Beijing and the ability to defend Taiwan against an attack.The document laid out a vision for the region in which North Korea no longer posed a threat, India was predominant in South Asia and the U.S. worked with partners around the world to resist Chinese activities to undermine sovereignty through coercion. It assumed that China would take "increasingly assertive" steps to compel unification with Taiwan and warned that its dominance of cutting-edge technologies like artificial intelligence would "pose profound challenges to free societies."

The Trump administration's actions to counter China in Asia had largely enjoyed bipartisan support. Even Biden officials have talked about the need to work more with allies and partners against China, which also going to form a key part of the strategy, particularly in strengthening security ties with Australia, Japan, and India.

Now let us see the ties of The United States with the European Union.

In January 2021, The European Union's top officials breathed a sigh of relief that Joe Biden would be taking over as president of the United States, but they warned that the world has changed after

four years of Donald Trump and that trans-Atlantic ties would be different in the future.The EU's 27 heads of state and government, said that trans-Atlantic relations have greatly suffered in the last four years. In these years, the world had grown more complex, less stable, and less predictable.

The European Union said that theirdifferences would not magically disappear. America seemed to have changed, and how it's perceived in Europe and the rest of the world has also changed,The Council believed in a strong mutually beneficial long-term strategic partnership with the United States, in a strengthened multilateral order, which would promote a shared vision of the world and could achieve tangible results.A renewed transatlantic agenda was necessary to find joint answers to global challenges, to safeguard the health and wellbeing of their people and their planet, to protect democracy, and make it deliver for their citizens.

By pursuing its strategic course of action and increasing its capacity to act autonomously, a stronger European Union would actively contribute to strengthening the transatlantic partnership and its ability to deliver. Now let us focus on the ties of India, EU, and Indo-pacific

: India, The European Union, and Indo-pacific ties

In the 21st century, as the economic and strategic centre of gravity shifts towards the Indo-Pacific region, the rapidly rising interconnectedness and inter-dependence between the Indian and the Pacific Oceans has resulted in a more integrated view of the two.

The rise and increasing salience of the Indo-Pacific in regional and global discourses is coupled with intense geopolitical churnings in the region. As the world strives to embrace the transforming geopolitical realities in the region, Europe has so far not figured prominently in the debates around the Indo-Pacific.

However, gradually European countries are beginning to pay attention to the region, particularly France and Germany which have been more proactive recently to acknowledge the significance of the Indo-Pacific to Europe's security and prosperity. *The French strategy for Indo-Pacific 2019stresses* that" security of the Indo-Pacific is a strategic challenge".

India and the EU have been strategic partners since 2004, however, the focus of the relationship has been more on economic aspects and not so much on strategic issues. However, as the EU begins to take cognizance of the strategic significance of the Indo-Pacific and reassesses its role in the region, India would be a crucial partner for the EU. EU's new *India Strategy 2018* recognized the significance of relations with India, in pursuing its security interests, promotion of effective multilateralism, growth and prosperityin the Asian region, and tackling global challenges.

The Indo-Pacific essentially characterizes the vast maritime geography 'stretching from the shores of Africa to that of Americas' incorporating the Arabian Sea /Gulf region, the Indian Ocean, the South China Sea, and the Pacific Ocean.

India is a crucial player in the Indo-Pacific region, given its strategic location at the centre of the Indian Ocean and its extensive coastline of 7500 km, growing, economic, maritime military capabilities, strategic ambitions in the wider Indo-Pacific, and keenness to strengthen partnerships with countries across the region.

Europe, although geographically not a part of the Indo-pacific region, a large chunk of Europe-Asia trade passes through the critical chokepoints located in the Indo-Pacific region. Any threat to the vital sea lanes and bottlenecks, and any conflict in the region, challenging the flow of energy and commerce, will have a direct impact on Europe's prosperity and security. Given these stakes, many policymakers in Europe have begun to recognize the EU as a key stakeholder in the security of the Indo-Pacific.

As Asian security is inherently connected to European economic prosperity, there is a compelling need for the European Union to formally acknowledge the new power narrative of the Asia-Pacific by adopting an Indo-Pacific strategy. Primarily to safeguard European economic interests in the region as well as to increase the EU's profile as a global security provider and strategic partner for its allies in Asia.

Let us now consider the economic perspective of Latin America.

In 2021, the outlook remains clouded by several downside risks, including social unrest in several countries, elevated unemployment, deteriorated fiscal metrics, further flare-ups of the virus, and a potentially slow vaccine rollout.

Monetary authorities in Brazil, Chile, Colombia, Mexico, Paraguay, and Uruguay held their benchmark rates steady at or near record lows at their December 2020 meetings, while the Central Bank of Peru also stood pat at its first meeting of FY 2021. In 2021, central banks across the region are expected to maintain loose stances.

Most regional currencies weakened against the USD in recent times, most notably the Brazilian real and Colombian peso, the former due to concerns over the pandemic and public finances, as well as a slow reform agenda, and the latter owing to a drop in crude prices. Meanwhile, currencies in Chile and Mexico gained strength.

This summarizes the multilateralism among various regions across the globe in recent times and would certainly help in understanding this concept well.

Summary

International business negotiation is defined as the deliberate interaction of two or more social units (at least one of them a business entity), originating from different nations, that are attempting to define or redefine their interdependence in a business matter.

The process of negotiation can be broken down into two three stages namely the pre-negotiation phase, the negotiation phase, andthe post–negotiation phase.

Culture consists of patterns, explicit and implicit, of behaviour acquired and transmitted by symbols including their embodiment in artifacts. The essential core of culture consists of traditional ideas and values.

Asset protection is the concept of and strategies for guarding one's wealth against taxation, seizure, or other losses.

The goal of a comprehensive asset-protection plan is to prevent or significantly reduce risk by insulating business and personal assets from the claims of creditors.

Multilateralism is a process of organizing relations between groups of three or more states.It is considered to comprise certain qualitative elements or principles that shape the character of the arrangement or institution.

Keywords

International business negotiation: Itis defined as the deliberate interaction of two or more social units (at least one of them a business entity), originating from different nations, that are attempting to define or redefine their interdependence in a business matter.

Asset protection: It is the concept of and strategies for guarding one's wealth against taxation, seizure, or other losses.

Trust: It is an agreement between the person creating the trust (referred to as the settler, trustor, or grantor) and the person responsible for managing the assets of the trust (the trustee).

Multilateralism:It is a process of organizing relations between groups of three or more states.It is considered to comprise certain qualitative elements or principles that shape the character of the arrangement or institution.

Self-Assessment

1. _________________is defined as the deliberate interaction of two or more social units (at least one of them a business entity), originating from different nations, that are attempting to define or redefine their interdependence in a business matter.

   A. Culture
   B. International business negotiation
   C. Risk propensity
   D. Assertive communication

2. Which of the following is not included in the negotiation phase?

   A. Price issue
   B. Timing
   C. Culture
   D. Dispute settlement

3. Which of the following is not a phase in process of negotiation?

A. Pre-negotiation phase
B. Negotiation phase
C. Post-negotiation phase
D. Support-negotiation phase

4. ____________consists of patterns, explicit and implicit, of behavior, acquired and transmitted by symbols including their embodiment in artifacts.

A. Risk propensity
B. Timing
C. Culture
D. D) Cognitive

5. Which of the following is not a cultural value on the international business negotiation process?

A. Protocol
B. Risk propensity
C. Communication
D. None of these

6. ____________is the concept of and strategies for guarding one's wealth against taxation, seizure, or other losses.

A. Risk propensity
B. Asset protection
C. Fraudulent practices
D. None of these

7. The goal of a comprehensive asset-protection plan is to prevent or significantly _________risk by insulating business and personal assets from the claims of creditors.

A. Increase
B. Elevated
C. Reduce
D. D) Subtle

8. Which of the following is not an asset protection strategy?

A. Corporations
B. Trusts
C. Specific partnership
D. General partnership

9. _____________is a process of organizing relations between groups of three or more states.

A. Culture
B. Multilateralism
C. Trusts
D. None of these

10. ISEAS stands for__________.

A. Institute of Southeast Asian Studies
B. Institute of Southwest African Studies
C. Institute of Southern Asian Seminars
D. Institute of South American Studies

11. Which of the following best defines international business?
    A. It includes all economic flows between two or more countries.
    B. It includes all private economic flows between two or more countries.
    C. It includes all business transactions involving two or more countries.
    D. It includes all business transactions in countries other than your home country.

12. When a company successfully responds to foreign production and market opportunities, ________.
    A. other companies will likely emulate its successful practices
    B. it likely has a long-term advantage over competitors
    C. it will downsize its domestic operations
    D. its home government likely raises taxes on the company

13. What is the most likely reason that governments cooperate with each other through treaties, agreements, and consultations?
    A. to gain an advantageous division of labour
    B. to comply with United Nations' requirements
    C. to attack problems jointly that one country acting alone cannot solve
    D. to assure that all countries get an equitable share of taxes from multinational enterprises

14. Although globalization may bring economic growth, critics nevertheless contend that ________.
    A. the growth is too fast
    B. the inequality of gains puts some people in a relatively worse economic situation
    C. this growth is mainly for the future, thus ignoring present economic growth needs
    D. the cultural foundations of sovereignty are supported by globalization

15. Which of the following BEST explains how a firm reduces risk by operating internationally?
    A. taking advantage of business-cycle differences among countries
    B. buying competitive risk insurance unavailable domestically
    C. preventing competitors from operating in the countries it has entered
    D. operating in less competitive environments than those at home

Answer for self Assessment

1.	B	2.	C	3.	D	4.	C	5.	D
6.	B	7.	C	8.	C	9.	B	10.	A
11.	C	12.	A	13.	C	14.	B	15.	A

Review Questions

1. What do you understand by international business negotiation? Discuss in brief along with an example.

2. Define the term Asset protection. Explain in brief how is it helpful to multinational enterprises?

3. Discuss in brief the process of negotiation along with an example.

4. What do you understand by multilateralism? How do you think it's important for international business?

5. Discuss in brief the asset protection strategies adopted by international firms.

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Unit 13: Country Evaluation & Selection

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Objectives

After studying this unit, you should be able to

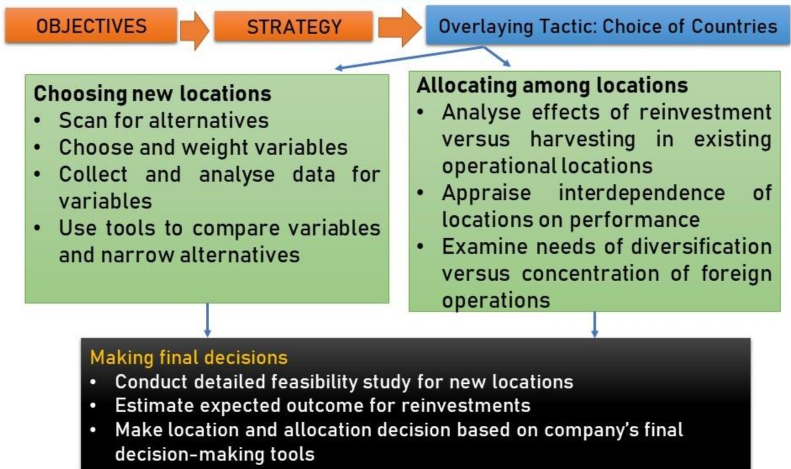
- illustrate major opportunities and risk variables when deciding whether and where to expand abroad
- discuss the macro indicators that influence the international business operations
- discuss the micro indicators that influence the international business operations
- analyzethe country comparison tools that are being used in international business operations

Introduction

Companies, facing globalization and technological revolution, are constantly forced to search for new ways to grow and develop. A profitable growth strategy can be built through international expansion. Recently it has become one of the few effective ways to develop and enhance the competitiveness of a company in response to the changing dynamics of the global economy. When a company is expanding its business operations to overseas markets several strategic decisions must be taken. The company must define the product it wants to market (what), the country market it wants to enter (where), the timing of entry (when), and the entry mode it wants to use (how). Consequently, the country's market selection plays a critical role in shaping the performance of foreign activities and influences the future success of the company. This is a complex and difficult decision, requiring the company to analyze a wide spectrum of factors that affect both investment efficiency and effectiveness. The location selection in international expansion may be determined by general macroeconomic factors, demand factors, socio-political factors, or cost factors.

13.1 The Location Decision Process

The adage that location, location, and location are the three most important factors for success rings true for international business. The world has a bit more than 200 countries, each offering distinct opportunities and risks.Committing resources to a foreign location may entail risky trade-offs- say, forgoing, or abandoning projects elsewhere. The start of the decision-making process is essentially twofold: Examining the external environments of proposed locations and comparing each of them with the company’s objectives and capabilities.



As we can see from the above chart, the objectives of the organization lead to the choice of strategy that it would like to adapt. Now the strategy will help in choosing the new locations. It is going to undertake the following measures like scan for alternatives, choose and weight variables, collect and analyze data for variables, and use tools to compare variables and narrow alternatives. Alongside this allocation among locations would also take place that includes analysing effects of reinvestment versus harvesting in existing operational locations, appraise interdependence of locations on performance, and examining needs of diversification versus concentration of foreign operations. Both these scenarios lead to final decision-making activity that includes conductinga detailed feasibility study for new locations, estimate expected outcomes for reinvestments, and make location and allocation decisions based on the company's final decision-making tools.

Here one interesting thing that needs to be seen is why more emphasis has been given to scanning? The reasons for the same are:

- Scanning is like seeding widely and then weeding out
- Without scanning, a company may examine too many or too few possibilities.
- In scanning, managers examine many countries broadly using information that is readily available, inexpensive, and fairly comparable to narrow detailed analysis and travel to only the most promising ones.

Let us try and figure out the difference between scanning and detailed analysis

Scanning

Scanning answers four types of questions:

- Does the country allow 100% ownership of foreign direct investment? (Category: Yes or No)
- What is the highest marginal tax rate on corporate earnings? (Category: Direct statistics)
- What are the potential sales for the product of the company? (Category: Indirect indicators)
- What will be the future political leaders' philosophy about international business? (Category: Qualitative assessment)

Detailed Analysis

Once narrowing the number of countries, managers need to compare them in greater detail.They always need to go toa location to collect and evaluate more specific information.

The more time and money companies invest in examining an alternative, the more likely they are to accept it, regardless of its merits, a situation is known as an escalation of commitment. A feasibility study should have clear-cut decision points, whereby managers can discontinue the commitment before they invest too much.

Opportunity & Risk Variables

Companies need to consider opportunity and risk indicators that could significantly affect their success or failure. Let us consider first the opportunity variables, these are:

- Sales Expansion
- Resource Acquisition

Sales Expansion& Resource Acquisition

The expectation of a large market and sales growth are probably a potential location's major attractions. Let us understand the same with help of an example.

Major global retailers were looking for an entry in India in 2019

Entering a market as big and complex as India's is a big bet, but success is by no means guaranteed as China shows, the other promised retail land in Asia. Still, more than 40 mid-rung global retailers were planning to enter India in 2019-20, thanks to the virtuous circle of rising in ease of doing business coupled with booming urbanization and growing middle-class.Brands such as HEMA, Delifrance, Petit Bateau, Magnolia Bakery, Marco Pierre White, Monnalisa, and many more from the United States, Europe, and Australia spread across almost all sectors would be investing about $250-300 million. These brands cumulatively about to open around 2000-2500 stores by 2024.

Unlike most large global retailers which focus on urban cities, some of these mid-sized brands were looking actively at tier 2 cities and beyond which were said to be the future canters of retail growth in India. Also, as retailers struggled in their home markets, the success of brands such as IKEA, Miniso, and Uniqlo seemed to be a good reason why India had become a curious choice in 2019.

Deloitte believed small and mid-sized brands were also aggressively looking to cash in on the open retail policy and a huge gap in the market for branded products. The changes in single-brand retail trading norms, allowed brands to use their global sourcing volumes out of India against the local sourcing, and the low household penetration was attracting a lot of brands.

For a long, some brands have refrained from entering India because of the mandatory brick-and-mortar rule primarily because of the high cost of commercial real estate in high streets or shopping malls.The decision to allow brands to operate an online-only model, and open brick-and-mortar outlets within the first two years of starting online, however, had spurred the interest in global retailers who have been upbeat about the country's consumption story despite the economic slowdown in 2018-19. The two-year window, was enough to test the waters first and then open stores on their own or with a local partner depending on the consumer response to a particular brand and its scope of business.

Tiffany, which operates more than 320 stores in over 25 countries with over 80 in Asia-Pacific, as well as e-commerce websites in 14 markets, was also targeting the world's second-biggest gold jewellery market. As a global luxury jeweller with stores in many of the world's most important cities, Tiffany's emergence in these Indian commerce centres with its growing luxury consumer base presents a unique opportunity. Iconic American jeweller Tiffany & Co was planning to enter the Indian market in partnership with billionaire Mukesh Ambani's Reliance Industries and planned to open its first store in Delhi.

The largest Japanese fashion company and one of the world's top four fast-fashion brands, Uniqlo, was also preparing to come to India in 2018-19. Uniqlo was looking to enter India on its own and was in talks with mall developers in top cities to open stores.

Founded in 2013, fast-fashion brand Minisco that sells its products through more than 1,400 standalone stores in 31 countries was also looking to enter India. The company generally appoints franchisees for its brand but would open company-owned stores in India and later appoint sub-franchisees.

A Japanese designer brand Miniso, which had a presence in 86 countries, operated as many as 102 stores in India, a market it claimedwas among the top-5 contributors to its top line. The company's USP was its low-products that came in the Rs 75-1,500 range.The Indian economy has been one of the fastest-growing economies in the world. Many American and European brands have dominated the lifestyle industry here and have thrived.

Seeing the opportunity and gauging the huge growth potential that the market had to offer, Miniso realized that it was the right time to enter the Indian subcontinent. The company got an overwhelming response for its products since the establishment in India.The Indian market had shown a vast potential for brand expansion and the company was fully intended to follow through on the opportunity, keeping the Indian taste and preferences in mind. Realizing the price sensitivity

of the market, the products offered lie within the range of Rs 75 to Rs 1,500, making them accessible to everyone.

By the end of the year 2019, Miniso had bigger plans for the Indian market. It wanted to increase local sourcing. The company would hit a $3 million purchase from India as it was expected in 2019 and by 2020,Miniso hoped to purchase goods worth $25 million from Indian suppliers. The company wanted to buy and manufacture products in India, followed by a design finish in Europe and Japan, and then exported to different countries.

In 2019, Miniso was purchasing products from 40 countries but had also been witnessing supply chain pressures. It then wanted to shift purchase orders to India for cosmetics and textiles. Since 2014, Made in India has taken off India, and Indiahad become the second biggest purchase country for Miniso sales arms, the first being China. Products made in India were already exported to Indonesia, Malaysia, and China.

To deepen the Indian market, MINISO insists that more Indian consumers can enjoy products with high appearances, high quality at a good price. During the pandemic, the Indian team of MINISO increased the local sourcing, to ensure the supply of commodities, and keep the products update frequency, and offering tempting discounts.

The above-mentioned companies example reflects that when an organization tends to move in international geographies, objectives such as sales expansion and resource acquisitions always remain in the mind of the management of such organizations.

Now let us move on to risk variables and these are:

- Political Risk
- Foreign-Exchange Risk
- Natural Disaster Risk
- Competitive Risk

The risks mentioned above impact the decision-making of the organization and accordingly management of the organization takes a call whether to move to such geographies or not. Like we have already discussed in previous units as well that political instability can lead to companies change their mindabout moving to such locations where the government of the economy is not stable enough to assure long-term business operations commitment.

Every business is affected by a myriad of factors. In other words, an organization as such can never exist and operate "in a vacuum". It is a part of a larger entity known as the business environment. In broad terms, this environment can be divided into two categories. The first one is the micro-environment. This category influences the functionality of a particular business itself. The latter one is the macro-environment which affects the operation of all existing business entities out there.

13.2 Macroeconomic Indicators

Macroeconomic indicators are statistics or data readings that reflect the economic circumstances of a particular country, region, or sector. They are used by analysts and governments to assess the current and future health of the economy and financial markets.Macroeconomic indicators will vary in their meaning and the impact that they have on the economy, but broadly speaking there are two main types of indicators.

Types of Macroeconomic Indicators

These are:

- Leading Indicators
- Lagging Indicators

Leading Indicator

A leading indicator is any measurable or observable variable of interest that predicts a change or movement in another data series, process, trend, or another phenomenon of interest before it occurs.Leading economic indicators are used to forecast changes before the rest of the economy begins to move in a particular direction and help market observers and policymakers predict significant changes in the economy.

Types of Leading Indicators

These are as follows:

- GDP
- Employment Figures
- Industrial Production
- Consumer Spending
- Inflation
- Home Sales
- Home Building
- Construction Spending
- Manufacturing Demand
- Retail Sales

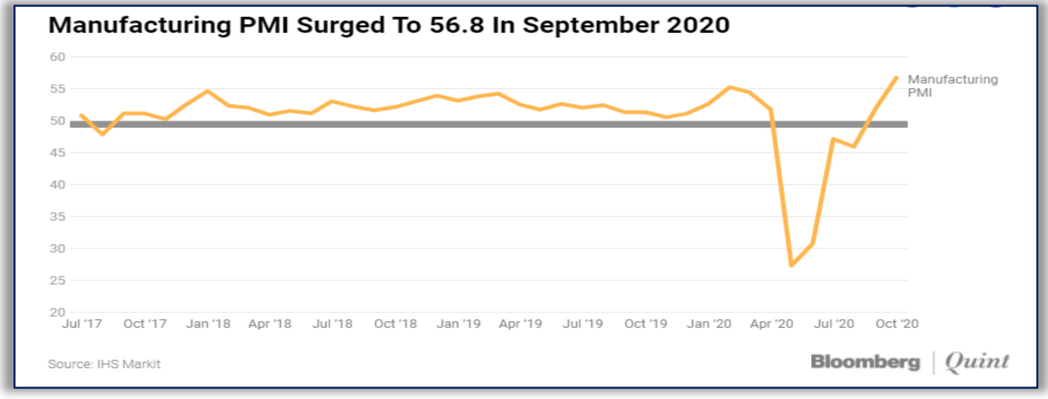
Leading indicators must be measurable to provide hints as to where the economy is headed next. Investors use these indicators to guide their investment strategies as they anticipate future market conditions. Policymakers and central bankers use them when setting fiscal or monetary policy. Businesses use them to make strategic decisions as they anticipate how future economic conditions may affect markets and revenue.

Leading indicators are often based on aggregate data gathered by respected sources and focused on specific facets of the economy. For example, economists closely watch the Purchasing Managers Index (PMI) predict growth in a nation's gross domestic product (GDP) due to changes in the demand for materials from corporations. The same can be understood with help of an example from an economy like India.

In September 2020, India manufacturing PMI surged to the highest in the last eight years.

The Indian manufacturing industry continued to move in the right direction, with PMI data for September 2020 highlighted many positives. Due to loosened Covid-19 restrictions, factories went full steam ahead for production, supported by a surge in new work.

Production and manufacturing statistics can be one of the easiest and quickest ways to get leading data on the state of the economy. An increase in production and manufacturing outputs tends to have a positive impact on gross domestic product (GDP) figures, which is seen as a sign of increased consumption and positive economic growth.



Lagging Indicator

A lagging indicator is an observable or measurable factor that changes sometime after the economic, financial, or business variable it is correlated with changes. Lagging indicators confirm trends and changes in trends. They can be useful for gauging the trend of the general economy, as tools in business operations and strategy, or as signals to buy or sell assets in financial markets.

A lagging indicator is a financial sign that becomes apparent only after a large shift has taken place. Therefore, lagging indicators confirm long-term trends, but they do not predict them. This is useful because oftentimes many leading indicators are volatile, and short-term fluctuations in them can obscure turning points or lead to false signals. Looking at lagging indicators is one way to confirm whether a shift in the economy has occurred.Some general examples of lagging indicators include the unemployment rate, corporate profits, and labour cost per unit of output. Interest rates can also be good lagging indicators. Let us continue the example of the Indian economy for lagging indicators as well.

In December 2020, India's high-frequency indicators suggest economic recovery at a brisk pace.

Most high-frequency data points suggest a pick up (GST Collections, Auto sales, Manufacturing PMI, India imports, E-way bills), December GST collections came in at 21 months high. December GST collections at Rs 1.15 lakh crore, up about 12% YoY was the highest since April 2019

Every day, the news is blanketed with stories about global economies, unemployment, government spending, currencies, and stock market performance – all components of macroeconomics. But underpinning all these is microeconomics. If the average person or business doesn't spend money, nothing else matters. The word economics comes from the ancient Greek word "oikonomos" – "one who manages a household." This is the heart of microeconomics – from buying coffee to batteries to houses; it's all about why everyday people spend money, on what, how, and where.

13.3 Microeconomics Indicators

Microeconomics refers to the more company-specific economic factors. This includes things like specific industries or niches, changes in tax policy, price changes competitors make, and the general supply and demand. Microeconomics helps businesses understand why consumers choose to spend their money and on what. The science behind the way consumers and even businesses purchase can influence what is sold, how, and why.

Ultimately, nearly all business is about supply and demand. Ideally, someone has something to sell; someone needs that something, or vice versa. This is probably the most widely-known principle of microeconomics, but it goes so much further than that.Microeconomics is essentially about choice. Very few people in the world can buy everything they want. For most consumers, money is a limited resource. To spend money, they make choices about wants versus needs.

Consumers can't have what they can't afford, though, and this is where microeconomics comes into the equation because it helps to understand why someone will sacrifice a spare bedroom for a larger kitchen whereas someone else will compromise on everything else to have that spare bedroom.For businesses, microeconomics both guides their daily choices on how they spend their money and why, as well as dictating whether, and why or why not, their target audience patronizes their business.

As an example of a choice guided by microeconomics for a business, take the dilemma of whether to spend marketing funds on getting a new branded awning for the storefront or designing a new website. Both cost the same amount of money. Both are replacing something that's already existing, but which of them works since both the website and the awning are functioning just fine as-is. So where do they spend the money, and why?

On a day-to-day basis, the owner decides the money spent on the website will outperform that spent on an awning, so the company goes with a website redesign.Meanwhile, a few months later, a customer needs to buy glue for the models they're making. A local company sells a serviceable glue, but it's not professional-grade glue because it doesn't dry completely clear and doesn't have an extra-long adhesive life.He's found a website for McCally's Crafting. Their glue costs 15 percent more plus the shipping fee, too. Should he spend more? He decides his model schooner will be more attractive and durable with a professional glue.

It'll tap out his disposable budget for the week, but he can skip buying lunch at work for two days since he's got dinner leftovers. His savings on lunches will cover the shipping. Later, maybe his schooner will look so good he could sell it on e-Bay.Despite the higher prices, he chooses McCally's glue because he decides he will ultimately get more out of a better product and may even have a saleable item at the end of it, which could make him a profit.These cost-benefit ratios are something people do every single day when making purchasing decisions.

Let us take a company-specific example to understand it well.

Hyundai planned a multi-pronged strategy to beat the slowdown in India in May 2020.

Hyundai Motor India Ltd, the country's second largest passenger vehicle maker, had decided go ahead with its planned investments despite the coronavirus outbreak. It was also devising a multi-pronged strategy to counter the economic slowdown, which was expected to last till December 2020 and might impact overall industry volumes by more than 25%. Hyundai planned to push new and cheaper vehicle-ownership models, such as subscription-based offers in metro cities, besides retooling its used-car business strategy.

As per the company, the needs of customers would probably change and some might look at total ownership, while others might prefer subscription-based offers, as mobility needs would change and affordability was going to be a crucial factor. The advantage (of the subscription model) is that the customer is not bound to an EMI for four to five years and can try different cars for varying periods. There is no problem of registration, insurance, and other payments. This should have a lot of traction for many customers, especially in urban areas.

In summation, both aspects of the economy are closely related, though they each provide a unique viewpoint. Macroeconomic indicators are useful for making broad, long-term predictions, and microeconomic indicators are useful for gauging supply and demand, and thus they can be helpful for price setting.

13.4 Tools for Country Evaluation & Selection

Many tools can be utilized by the organizations while looking for country evaluation and selection process. These are:

- Opportunity-Risk Analysis
- Trade Analysis and Analogy Methods
- Products-Country Matrix Strategy
- Market Focus Strategies
- Growth-Share Matrix
- Country Attractiveness-Company Strength Matrix

Opportunity & Risk Variables

Companies need to consider opportunity and risk indicators that could significantly affect their success or failure.Teams comprising people from different functional areas are useful in choosing and rating indicators of countries' opportunity and risk. The team will consider some conditions as more important than others, say that political risk is more important than natural disaster risk.Grids are tools that may depict acceptable country conditions, rank countries by important variables. This grid is a simplified example of a grid with information placed into three categories:

- Acceptable/unacceptable conditions
- Opportunity indicators
- Risk indicators

Analysing and Relating the Opportunity & Risk Variables

Country Variable	Weight	I	II	III	IV	V
1. Acceptable (A), Unacceptable (U)						
a. Allows 100% foreign ownership	-	U	A	A	A	A
2. Opportunity						
a. Sales potential	0-5	-	4	3	3	3
b. Labor conditions	0-3	-	3	1	2	2
c. Infrastructure	0-2	-	2	1	2	2
d. Ease of external integration	0-4	-	3	2	4	1
e. Possibility of governmental incentives	0-3	-	2	1	3	1
f. Tax rate	0-2	-	2	1	2	0
Total	-	-	16	9	16	9
3. Risk (lower number=preferred rating)						
a. Political	0-4	-	2	1	3	2
b. Foreign exchange	0-3	-	1	0	3	3
c. Natural disaster	0-4	-	0	0	4	3
d. Competitive	0-2	-	0	1	2	2
Total	-	-	3	2	12	10

In this example, that country "I" can be immediately eliminated because the company will go only where it can take 100 percent ownership. Although in this example sales potential is given more weight than infrastructure as an opportunity indicator and political is given more weight than competitive as a risk indicator, different companies will choose indicators and weigh them differently. Here managers eliminate option 1 because the company will go only where 100 percent foreign ownership is allowed. Country II is the most attractive because it's regarded as having the high opportunity and low risk.

Country III offers low opportunity and risk, and country IV has high opportunity and risk. Country V is eliminated because of having the low opportunity and high risk. So, accordingly, companies can make their choices as far as their entries to different geographies are concerned.

Opportunity-Risk Matrix

Countries E & F are the most desirable because they boast a combination of a high level of opportunity and a low level of risk. But what if the decision came down to countries A & B?

The level of opportunity in country A may not be high as a company would like, but the low level of risk may be attractive. Country B, however, promises a high level of opportunities but also threatens a high level of risk. A decision between countries A & B will probably consider the firm's risk tolerance.

Trade Analysis & Analogy Methods

Trade analysis and country analogy methods are widely used for country evaluation by estimating their market size. The market size of a country may be determined by subtracting the exports of a product from the sum-total of its and imports.Published data on export and production imports can be obtained through international sources, Such as WTO, International trade centre, and United nations conference on trade and development. National governments comply with trade statistics through customs and central banks, for instance, in India, through DGCI&S and Reserve Bank of India.

Production statistics are generally available through government organizations for broad product categories, such as agricultural commodities, textiles, steel, cement, minerals, etc. More product-specific statistics are compiled by commodity organizations and trade associations.

For new product categories, with little consumption and production in the past, various types of analogy methods are employed. In the analogy method, a country at a similar stage of economic development and comparable consumer behaviour is selected whose market size is known.

Besides, a surrogate measure is also identified, which has similar demand to the product for the international market. Alternatively, the analogy method for different periods, which may be compared with similar demand patterns in two different countries, may also be used.

Product-Country Matrix Strategy

To examine market diversification and commodity diversification, the product-country matrix strategy is employed. Under this approach, previous trade statistics are analyzed to identify the major markets and major products, based on which a suitable marketing strategy is developed.The matrix based on a predominantly supply-side analysis reveals comparative advantages.

Country Attractiveness-Company Strength Matrix

An analysis may be carried out for country evaluation and strategy development based on the business attractiveness of countries and the competitive strength of the company.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, productfit to the market, demands, image, contribution margin, technology position, product quality, financial resources, access to distribution channels, and their quality.

Primary Markets:

These countries offer the highest marketing opportunities and call for a high level of business commitments. The firms often strive to establish a 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 to take care of the limitations of operating business.

Tertiary markets:

These are countries with high perceived risks; therefore, the allocation of a 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's attractiveness and company strength both are very low.

However, a firm may use licensing as a mode of business operation with little resource commitment but continue to receive royalties. Countries at the extreme right top of the matrix signify higher country attractiveness but lower company strength.A firm should identify its competitive weaknesses in these countries and strive to gain competitive strength. It may also enter into a joint venture with other firms, which most of the time are local and have complementarities to gain competitive strength.

In countries where a firm has medium competitive strength and country attractiveness needs to carefully study the market condition and adopt the appropriate strategy. Let us consider an example.

Ford gave up control in India after struggling to make in-roads

Ford tractors used the country attractiveness-company strength matrix and placed India under the extreme right top of the matrix wherein the country attractiveness was very high but the competitive strength of the company was low.

Decisions to expand business across national boundaries require a much higher level of commitment of a company's resources as any business failure may have serious repercussions. By way of effective evaluation and selection of countries, the internationalizing firm avoids wastage of time and resources and it can focus its efforts on a few fruitful locations.

Ford thought of making a joint venture with Mahindra and Mahindra. The deal effectively ends Ford's independent operations in a country it wanted to become one of its top three markets by 2020. The U.S. carmaker will take an $800 million to $900 million impairment charge related to the value of its Indian assets after struggling to compete with cheap, fuel-efficient vehicles built by the local units of Suzuki Motor Corp. and Hyundai Motor Co.

The agreement, which includes cooperating on electric cars for emerging markets, comes at a time when sales of cars and SUVs in India are going through the worst-ever slump. A slowing economy, dwindling rural income, and rising popularity of ride-hailing and car-sharing services are weighing on vehicle demand.

Summary

Companies need to consider opportunity and risk indicators that could significantly affect their success or failure.

Macroeconomic indicators are statistics or data readings that reflect the economic circumstances of a particular country, region, or sector.

A leading indicator is any measurable or observable variable of interest that predicts a change or movement in another data series, process, trend, or another phenomenon of interest before it occurs.

Microeconomics refers to the more company-specific economic factors. This includes things like specific industries or niches, changes in tax policy, price changes competitors make, and the general supply and demand.

Keywords

Leading indicator: It is any measurable or observable variable of interest that predicts a change or movement in another data series, process, trend, or another phenomenon of interest before it occurs.

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

Self Assessment

1. Comparing countries in international business is LEAST useful for determining the ________.

A. best location for sales and production
B. sequence of entering different countries
C. amount of resources to allocate in each country
D. selection of which managers to send to which countries

2. Executives at Wilson Enterprises need to determine how to leverage and improve the firm's existing competencies on a global basis. What are the two most basic questions that they must answer?

A. Which markets should we serve and where should production be located to serve those markets?

B. What are the short-term competitive advantages of the project and what is the return on investment?
C. What is the total investment required and what are the managerial resources needed to supervise the investment?
D. What is the availability of land and what is the cost of labor?

3. A company's location should be flexible enough to ________.
A. implement concentration strategies instead of diversification strategies
B. respond to new opportunities and withdraw from less profitable ones
C. import from anywhere in the world to a single production location
D. export anywhere in the world from a single production location

4. Elison Enterprises is planning international geographic expansion. A manager at Elison has been given the task of scanning for locations primarily to ________.
A. reduce the number of options available to a manageable number for further detailed analysis
B. assure the compatibility between the mode of corporate operation and the country
C. assure that all countries within a region have similar investment climates
D. decide whether to use a concentration or a diversification strategy

5. Which of the following most accurately compares the techniques of scanning versus detailed analysis of countries?
A. Scanning is used for planning and detailed analysis is used for control.
B. Detailed analysis is used to consider countries overlooked in the scanning process.
C. Scanning considers a large number of countries so that only the most promising ones undergo a detailed analysis.
D. Scanning compares one country to another, whereas detailed analysis compares regions within a single country.

6. Opal Computers is considering international production expansion. After scanning to decide on a few countries to consider more closely, Opal managers will most likely need to ________.
A. identify firms with which to form joint ventures
B. add some more countries for closer consideration
C. travel to the locations to analyze and collect specific data
D. make final decisions by expanding in locations near their rivals

7. Sales expansion is probably the most important variable in determining international location decisions. This statement is most likely based on the assumption that ________.
A. consumer demand exceeds supply
B. increased sales will lead to more profits
C. the company will have a first-mover advantage
D. raw materials are available in the country targeted for sales

8. In terms of political risk, it is most accurate to state that high-risk ________.
A. affects all geographic regions of a country equally
B. affects all foreign companies in the same manner
C. if avoided, may lead to higher competitive risk
D. triggers government turnovers

9. ____________indicator is any measurable or observable variable of interest that predicts a change or movement in another data series, process, trend, or another phenomenon of interest before it occurs.

A. Lagging
B. Leading
C. Microeconomic
D. None of these

10. Which of the following is not a type of leading indicator?

A. GDP
B. Consumer spending

C. Corporate profits

D. Inflation

11. Which of the following BEST describes the purpose of using an opportunity-risk matrix for comparing countries?
A. narrow alternatives so decision-makers can make a detailed analysis of the strongest candidates
B. eliminate countries that have specific unacceptable conditions
C. determine whether to use a concentration versus diversification strategy for international expansion
D. estimate where competitors are most likely to globalize

12. The major use of the matrix as a tool in international location strategy is to ________.
A. pinpoint acceptable and unacceptable characteristics of countries
B. indicate the relative placement of countries in terms of attributes
C. rank countries based on expected investment return
D. show the degree of certainty for projected returns

13. Which of the following is the LEAST likely reason for inaccuracies in published governmental data?
A. translation errors from the host country language
B. limitations of government resources and finances
C. purposeful publication of misleading information
D. false information provided to data collectors

14. Unlike grids, matrices do not require managers to determine weights for factors that indicate risk.

A. True

B. False

15. When choosing international operating locations, companies should outsource the preparation of grids or matrices to experts rather than preparing them with their personnel.

A. True

B. False

Answer for self Assessment

1.	D	2.	A	3.	B	4.	A	5.	C
6.	C	7.	B	8.	C	9.	B	10.	C
11.	A	12.	B	13.	A	14.	B	15.	B

Review Questions

1. What is the relationship between a company's international market and its production location decisions? How do firms benefit from the use of scanning techniques when making location decisions?

2. What is scanning? What opportunities and risks are most relevant to scanning?

3. In a short essay, discuss why simply examining a country's per capita GDP and its population doesn't necessarily lead to a good estimate for potential demand.

4. What are the major types of published data that managers can use to compare countries? Describe the tools available to managers for making country comparisons.

5. What problems are common with the published data available about different countries?

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UNIT 14: Globalization and Society

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Objectives

After studying this unit, you should be able to

- illustrate the importance of social responsibility for the multinational enterprise while operating in different geographic boundaries across the globe
- discuss the ethical dilemmas of labor conditions in international business operations
- illustrate the role of ethics and environment in international business operations
- discuss the legislation for anti-competitive and unfair trade practices in international business operations

Introduction

Concepts of national identity, and family, job, and tradition are changing rapidly and significantly. There is concern that the competitiveness introduced by globalization is leading to more individualistic societies. On the other hand, rapid change can encourage fundamentalism, a desire for the past, and a loss of tolerance for differences in religion and culture. The nation-state is losing influence relative to global economic pressures, and in some countries, there is a failure or hesitation to develop social policies. All of these changes increase the likelihood that vulnerable people will be exploited, and threats to the human rights of less able people will increase.

So, people as consumers are being studied for their patterns and behaviors of spending. At one level globalization may have no significant impact on families and that our lives are 'normal' in most circumstances. Many people are not aware of how they form a crucial part of this phenomenon. The reality is that every single individual is affected in one way or another. These changes affect people's identities and cultural values, which sometimes become altered significantly. Whether it is between generations or intra-personally, new values can cause dissonance and conflict with existing deeper-rooted values. Sometimes such transitions and changes can further cause difficulty with internal growth and development.

The question that needs to be addressed here, is it only profit-making that needs to be considered as a goal by an organization while operating its business internationally? The answer to the same is No, it is not the only goal but one of the important among all.Societal responsibility is taking the centre stage among multinational enterprises in recent times and getting a lot of attention from the top management. Every organization is getting sensitive towards social responsibility and in some

economies, policymakers are making it mandatory to contribute towards the society from which these organizations are earning.

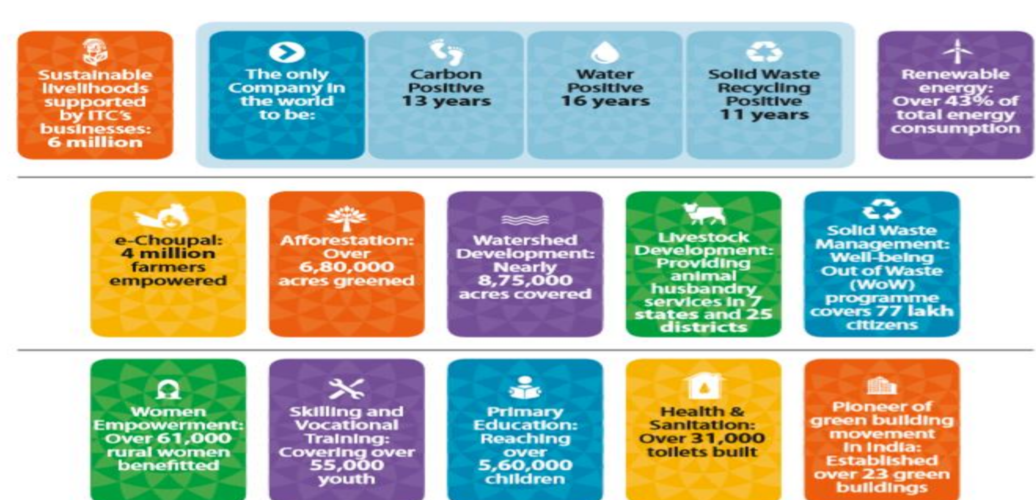
14.1 Societal Responsibility

Social responsibility in business, also known as corporate social responsibility (CSR), pertains to people and organizations behaving and conducting business ethically and with sensitivity towards social, cultural, economic, and environmental issues. Striving for social responsibility helps individuals, organizations, and governments have a positive impact on development, business, and society. Smart business decisions are not just a matter of counting short-term dollars and cents. Wise decision-makers consider the future impact of today's choices on people, the community, and customers and their opinions.

While business results, investment, free enterprise, and other traditional economic forces continue to drive industry, organizations' reputations and their ability to compete effectively around the world depend on them integrating social responsibility efforts into decision making and performance improvement. Let us consider an example to understand it well.

Indian Tobacco Company

The company follows what it calls, 'Triple bottom line' strategy. Under this, the aim is to create and sustain a business under three pillars - financial capital, environmental and social capital.The campaign is a unifying process. Each of its businesses has its brand team which focuses on driving a brand. This is the reason why most people don't know that the brand is from the stable of ITC. For instance, many people don't know that Aashirvaad Atta is from the house of ITC, despite the packaging featuring the logo.



Triple Bottom Line

Triple bottom line (TBL), in economics, believes that companies should commit to focusing as much on social and environmental concerns as they do on profits.The triple bottom line aims to measure the financial, social, and environmental performance of a company over time.The TBL consists of three elements: profit, people, and the planet.TBL theory holds that if a firm looks at profits only, ignoring people and the planet, it cannot account for the full cost of doing business.

TBL theory also says that if a company focuses on finances only and does not examine how it interacts socially, then that company is not able to see the whole picture, so cannot account for the full cost of doing business.

People + Planet = Social + Environmental Responsibility

People, planet, and profitis also known as the triple bottom lineare the three areas that businesses interested in sustainability measure their impacts. This varies from traditional businesses, which are predominantly focused on profits as their measure of success.

We can have another example here of Unilever.

Unilever Ltd

Unilever's Sustainable Living Brands are those that communicate a strong environmental or social purpose, with products that contribute to achieving the company's ambition of halving its environmental footprint and increasing its positive social impact. In 2018, Unilever's Sustainable Living Brands grew 69% faster than the rest of the business, compared to 46% in 2017; Unilever now has 28 Sustainable Living Brands – the four new entrants are Close Up (toothpaste), Wheel (laundry), Calve and Bango (dressings);Seven of Unilever's top ten brands – Dove, Knorr, Omo/Persil, Rexona/Sure, Lipton, Hellmann's and Wall's ice cream – are all Sustainable Living Brands.

Unilever's Sustainable Living brands include Dove, which has helped over 35 million young people around the world with self-esteem education since 2005.Vaseline, which has reached 3 million people living on the frontline of poverty and disaster with skin healing programs. Ben & Jerry's, which campaigns for social justice and climate change, and Rin whose Career Academy works with women across rural India, through mentoring and careers fairs.Lifebuoy, which has reached one billion people with its handwashing campaigns.

This campaign from Lifebuoy had helped to tackle the issue of diarrhea worldwide. The simple act of handwashing was the single most cost-effective way of stopping child deaths. It could reduce the number of incidences of pneumonia by 23 percent and diarrhea by up to 45 percent. Addressing social challenges like health and hygiene is not only good for society, it also makes business sense.

Unilever is working to create transformational change at scale, but the organization cannot do this alone. That is why the company is working in partnership with several organizations to create the change needed to address global health challenges.

Lifebuoy partnerships have grown in scale, innovation, and thought leadership, and form the backbone of their handwashing behavior change programs. These partnerships, with governments and non-government organizations (NGOs) enable the organization to have a greater impact and reach those most in need, playing a key role in impacting the sustainable development goals.

At Unilever, the management is very demanding of their brands with purpose. What they communicate must highlight an environmental or societal issue but more importantly, they must also take meaningful, long-term action with measurable results. This helps the organization to avoid empty statements that are not solving a real-world problem, because today, it is people who are driving culture – taking to the streets or social media to praise good behavior and punish bad.

Brands are responsible for not just reflecting culture but shaping it and the organization cannot ignore the seismic shift in people's identity and values or the heightened awareness of issues and stereotypes. People expect brands to step in to fill the void left by other institutions

Edelman's Trust Barometer, which states that 85% of respondents want brands to 'solve my problems, while 80% want brands to 'solve society's problems.All over the planet today, brands are responding with a sense of urgency to consumers' changing attitudes toward large corporations and their role in shaping, improving, and saving the world.

In early 2020, the Unilever homecare division announced its new global strategy: Clean Future. Billions of people around the world are asking for products that are tough on germs and stains, but also kinder to the planet.Science and technology now exist to make this possible and the organization will transform their brands to become lower carbon and lower waste, with the same or even better performance. The organization will play its part in the fight against climate change and help to preserve, restore, and regenerate the earth's natural resources.

Let us take an example of an Indian conglomerate Mahindra and Mahindra.

Mahindra and Mahindra

Mahindra Group had launched #CelebrateDifferently, under the group's theme of #RiseAgainstClimateChange. The campaign was a citizen-first initiative rolled out in June 2019, under its 'Hariyali' banner. The organization has started its cause for the environment back in 2007 wherein itcommitted to planting a million trees every year. With the help of such a campaign, the

organization was providing citizens with the opportunity to make a difference themselves to the cause.

Besides #CelebrateDifferently, the initiatives rolled out under girl child education like 'Nanhi Kali' have enabled and educated over 165,000 girls. The company also supported a pilot project for Project Nanhi Kali 2.0 which was expected to help aspiring girls complete their graduation as well as achieve proficiency in spoken English and digital literacy.

Employee social options or ESOPs is also an initiative through which employees 'give back' to society. Employees are encouraged to participate in initiatives like health camps and youth skills development through this program, a common practice among most large corporates. Many of these are designed to cater to specific local needs, such as a 14-day program for women in the automotive plant in Mumbai to develop their skills. As per the company, in FY19, 91 thousand ESOPs volunteers contributed nearly 600, 000 (6 lakh) man-hours to the initiative.

14.2 Ethics

Ethics can be defined as a system of moral standards or values. A sense of ethics is determined by several social, cultural, and religious factors.Ethics are not uniform across a business sector. When the ethics of an organization are unclear or unenforced, the expected conduct of organization members can become diffuse, and the organization may lose its ability to align its employees' efforts to work toward the organization's goals. The same result follows when an organization has a written code of ethics, but there is no commitment to disseminate, promote and enforce the expected behavior.

Business Ethics

Business ethics is the study of appropriate business policies and practices regarding potentially controversial subjects including corporate governance, insider trading, bribery, discrimination, corporate social responsibility, and fiduciary responsibilities.

International business ethics emerged quite late globally compared to the business ethics that came up in the 1970s. It was only in the late 1990s that international business ethics came to the fore especially so after the economic developments that occurred on a global scale.In the 1990s many businesses from developing countries expanded their operations and became multinational. The transactions between businesses and the governments increased as a result, which gave rise to many practical issues.

Culture and its relativity were one factor more prominent than the others. Other ethical issues in the context of international business are generally dealt with by the laws of the land, although all of them fall within the ambit of international business ethics.Globalization diminished the barriers between countries on the globe and called for the universalization of values for trade to occur smoothly.

Universal values were perceived to control the behavior in the commercial space. This led to ethical issues in the international business perspective, those that were unknown to date.Other theoretical issues arise from the diversity of business ethical traditions in various countries across the globe. In addition, comparisons made based on corruption rankings of a certain state or based ona gross domestic product of a certain economy also lead to ethical issues in the international arena.

A major challenge facing MNEs today is the labor conditions of foreign workers, whether in their offshore operations or their outsourced supply chains. They are especially critical in retail, clothing, footwear, electronics, and agriculture industries, in which MNEs typically outsource huge portions of production to independent companies abroad.

Major Labor Issues in International Business

Some of the primary labor issues in international business are:

- Fair Wages
- Child Labor
- Working Conditions
- Working Hours
- Freedom of Association

Let us consider an example t understand these issues well.

Kia Motors India Ltd.

In November 2020, unionized workers at Kia Motors Corp. extended their partial strike for several days to demand higher wages and bonuses amid the COVID-19 pandemic. The company didn't contact the union to narrow differences over wages and performance-based bonuses in the past 14 rounds of wage negotiations.

The union demanded the company increase the monthly basic pay by 120,000 won ($104) per person, offer 30 percent of its annual operating profit in performance-based pay, and extend the retirement age from 60 to 65.But the company proposed 1 1/2 months of merit-based remuneration, 1.2 million won in special COVID-19 allowance, 200,000 won in gift certificates, and certain company stocks instead of freezing wages for the year, which was rejected by the union.The union also asked the company to build a module component plant for electric and hydrogen vehicles inside Kia's existing plants, not in plants of parts affiliate Hyundai Mobis Company. It had expressed concerns about a possible reduction in the carmaker's assembly line workers due to Hyundai Mobis' plan to build an auto parts plant for the next-generation models. So, from the above example, we can see how fair wages can lead to issues for multinational enterprises.

Let us now consider another example of Ikea furniture where we would be able to see the issue related to child labor.

IKEA

In May 2007, Furniture giant IKEA had made the astonishing admission that some of its suppliers in the developing world used exploitative child labor, and others were involved in illegal logging which destroyed protected forests. The company explained, 'If you produce rugs in India and countries like this and if you have been there then you will know that many of these rugs are produced in the homes of individuals. So, how can anyone guarantee that at any given time a child is not sitting behind a loom in their homes?'Despite the challenges, IKEA thought of continuing in such countries, as the company said it would be irresponsible to move out in such situations.

The respected BBC presenter charged that it wasn't about being difficult. The company was only there because it was cheap. Human rights and environmental campaigners said that IKEA's self-proclaimed ethics were being squeezed in favor of profits. The above example reflects the issue of child labor.

Now let us consider an example to understand labor issues like working conditions and working hours.

Maruti Suzuki Ltd.

In April 2016, the factory regime in the Maruti Suzuki India plants underpins the state of industrial relations in the company. Workers perceived the management as distant and unresponsive, seeking only to obstruct their demands. Managers have been disinclined to negotiate with striking workers and union leaders, who were viewed as troublemakers and opportunists. Further, the management often hired muscle men as employees to check and inform on potential labor unrest.

This had cumulatively contributed to a growing climate of discontent and mutual suspicion, causing repeated labor strife and strengthening militant labor unionism. Since most of the workers were locals and train at the same industrial training institutes, they functioned and rebel as a cohort.

In addition, the introduction of Japanese work culture by the management, including constant cost reductions, a grueling work ethic, unyielding deadlines, unpaid overtime, and oppressive 'culture of rules' – had exacerbated discontent among workers. One of the main triggers of the labor unrest at the Maruti Suzuki India plants had been the uptake in the use of contractual labor as opposed to hiring permanent workers. This had been reflective of a wider trend in the organized private sector.

Discontent emerged from the fact that contract employees didpermanent work, as pointed out by a Supreme Court ruling in 2011. Further, they did not receive social benefits and were paid lesser than their permanent counterparts. So, organizations need to manage such instances appropriately to avoid issues that can hamper the overall productivity of the organizations.

Sources of Work-Related Pressures in the Global Supply Chain

Pressures for ethical behaviorconcerning workers

- Consumers
- Corporate investors (e.g., pension funds)
- NGOs
- Government
- Trade Union
- Media
- Individual investors

We can take the example of Amazon here to understand work-related pressures in the global supply chain.

Amazon

In June 2020, reports of unsafe working conditions at Amazon warehouses had attracted widespread attention and many questions were raised about whether Amazon fired whistleblowers who raised concerns about the lack of protection for employees at the company. A single video from CNN on the topic had been viewed over 300,000 times on YouTube and received nearly 1,600 comments. A group of nine U.S. senators including five former presidential candidates issued an open letter to CEO Jeff Bezos, where they seek more information about the employee firings.

In response to the hailstorm of criticism, Amazon had enumerated the actions it has taken to ensure workplace safety and support its employees, including implementing over 150 significant process changes, setting up testing stations in and regularly sanitizing its locations, and increasing employee pay. The above example indicated how such work-related pressures in the global supply chain affect the overall functioning of the organizations.

If we go by the statistics, almost half a billion people are working fewer paid hours than they would like or lack adequate access to paid work, according to a new International Labour Organization (ILO) report 2020.For millions of ordinary people, it's increasingly difficult to build better lives through work. Persisting and substantial work-related inequalities and exclusion are preventing them from finding decent work and better futures.That's an extremely serious finding that has profound and worrying implications for social cohesion.

The data shows that the mismatch between labor supply and demand extends beyond unemployment into broader labor underutilization. In addition to the global number of

unemployed (188 million), 165 million people don't have enough paid workand 120 million have either given up actively searching for work or otherwise lack access to the labor market. In total, more than 470 million people worldwide are affected.

Motivations for Corporate Responsibility

Companies need to act responsibly because of unethical and irresponsible behavior:

- Could result in legal sanctions,
- Could result in consumer boycotts,
- Could lower employee morale,
- Could cost sales because of bad publicity.

It requires developing a code of conduct

Codes of conduct involve four dimensions:

1. Setting a global policy that must be complied with wherever the company operates.
2. Communicating the code to employees, suppliers, and sub-contractors.
3. Ensuring that policies are carried out.
4. Reporting results to external stakeholders.

14.3 Sustainability

It involves meeting the needs of the present without compromising the ability of future generations to meet their own needs while considering what is best for the people and the environment.Sustainability involves understanding the relationship between business, humanity, and nature. Clean air, drinkable water, food, a clean environment, and shelter are fundamental to human survival and business existence.

Ethics and the Environment

Companies that extract natural resources generate air or water waste, or manufacture products such as autos that generate pollution need to be concerned with their environmental impact.Sustainability is no longer just good business practice. New businesses are emerging that are combining the idea of environmental responsibility and profitability.

Let us consider Business Roundtable (BRT), it is a group of nearly 200 CEOs representing the largest U.S. companies. BRT released a report titled "Enhancing Our Commitment to a Sustainable Future" in 2019, Delivering customers environmentally and socially sustainable products and services that help society pursue a fulfilling future.This means embracing circular economy models, such as designing for longevity and reuse and being willing to rebalance product portfolios away from unchecked consumption and damaging products toward full sustainability.Using corporate brands and political influence to support systemic changes that ensure equitable opportunities for all: This means lobbying for climate-positive legislation and increasing corporate transparency; driving change to move trade associations from lowest common denominator to highest common factor,and using brand and advertising to lead customers from unsustainable to sustainable behaviors.

Acknowledging that the resources upon which businesses depend are limited, and business models that thrive within the available resources of the planet are needed. This means setting and acting on emissions-reduction and other sustainability targets that are science-based and meet the needs of all human society, not just those within the corporate world.

Workshop on Systemic Change has called on companies to start being transparent about what they dubbed corporate political responsibility (CPR). If a company spends millions on green ad campaigns but tens of millions more lobbying politicians to pass laws that would protect business as usual, then the whole idea of corporate social responsibility (CSR) is undermined. The organizations are supposed to perform three things that will not only benefit consumers, society, and the environment, but also the companies' long-term profits. The first one is fully disclosing corporate political activity. This could seem "utopian" or naive in the wake of Supreme Court decisions that have allowed unlimited "dark money" contributions from corporations to candidates and politicians,but they also recognized that such behavior is increasingly unpopular with the public, as well as more likely to be revealed.It's harder than ever for companies to hide their

behavior, and if a company can take a leadership position in transparency, the authors wrote, they can gain a competitive edge.

The second thing is Aligning the political activity with organization public pronouncements and CSR efforts.Customers and shareholders do not appreciate hypocrites, and there has been a recent movement from investors to stop the hypocrisy and greenwashing.Climate Action 100+ is one such group of influential institutional investors, with a total of $33 trillion in assets under management, that is pushing the corporations that are the world's largest greenhouse-gas emitters to transparently commit their proclaimed concern for the future of the planet to action.

The third one is to support public policies that will enable the private sector to better pursue sustainability efforts and commitments. This does not mean supporting public policies that are financially disadvantageous to the firm, but on the contrary supporting policies that enable the firm to act more responsibly without suffering a competitive disadvantage.They suspect that a big part of the problem is the influence of money and corporate power in politics. Although not a panacea, creating new norms of CPR - coupled with radical transparency around corporate political action - is a promising step.

There are three general categories of business responses to the public policy environment—reactive, interactive, and proactive. Business efforts to influence public policy and government include not only individual company efforts but also business association efforts. For most businesses, some combination of the interactive and proactive approaches with government and other interest groups is most often the best approach. Businesses, individually and collectively; citizen interest groups; and NGOs all influence government policies. These entities often partner to influence public policy.

Greenwashing

Greenwashing is the process of conveying a false impression or providing misleading information about how a company's products are more environmentally sound. Greenwashing is considered an unsubstantiated claim to deceive consumers into believing that a company's products are environmentally friendly. Let us consider an example here to understand it well.

Greenwashing cost Walmart 1 Million dollars in 2017.

Walmart hadpaid $1 million to settle greenwashing claims that allege the nation's largest retailer sold plastic products that were misleadingly labeled "biodegradable" or "compostable" in violation of California law.The state law bans the sale of plastics labeled "biodegradable" (or labeled with similar language). California environmental officials have determined such claims are inherently misleading without disclaimers about how quickly the product will biodegrade in a landfill or in other environments where it may be disposed of.

Let us consider another example of apparel giants H&M and Zara. In July 2019, the Norwegian Consumer Authority (CA), the country's equivalent to the U.S. Consumer Protection Bureau, was calling H&M out. The CA told *Fast Company* that H&M was "misleading" consumers by failing to provide adequate detail about why their garments were less polluting than other garments.Without more information, it was unclear to the consumer whether H&M was engaging in sustainable manufacturing and sourcing, or simply painting itself as more sustainable than it was to sell more products.

According to Norwegian marketing law, claims about a product's main qualities must be easily accessible and understandable for the consumer. Claiming that a product is 'sustainable' when it is not immediately clear what about the product makes it 'sustainable' will often be misleading."

Now let us consider an example of a sustainable company here that can lead a way for other organizations.

Seventh Generation

The company's founder, Jeffrey Hollender, had the vision to create and nurture a company with sustainability at the core. Everything that the company does focuses on the triple bottom line of people, planet, and profit for the greater good. Seventh Generation, Inc. is an American company that sells eco-friendly cleaning, paper, and personal care products. Established in 1988, the Burlington, Vermont, based company distributes products to natural food stores, supermarkets, mass merchants, and online retailers.From their products—

which are made using only natural, recycled, or renewable materials—to their philanthropic efforts that seek to help create a sustainable community, Seventh Generation employs a well-integrated sustainability vision and strategy.

Seventh Generation's mission to inspire "a consumer revolution that nurtures the health of the next seven generations." This mission is a guiding light for the brand's leadership, operations, and marketing. It is the authentic touchstone for all its decision-making.Seventh Generation's 2025 goals include operating with 100% renewable energy. The brand is committed to sourcing all-natural or recycled materials.

It also plans to use solely zero-waste packaging and increase internal diversity. Further, Seventh Generation takes environmental accountability to the next level. It implements an internal carbon tax. The Social Mission Board is advocating for the company to double its carbon tax to $12 per ton of greenhouse gases emitted.

This tax increases internal incentives to be sustainable. The natural product maker also uses money from the tax to invest in eco-friendly retrofits and advancements. Setting goals, measuring your impact, and linking financial and environmental goals is key to championing sustainability.

Seventh Generation's #ReadyFor100 initiative is a great example of how brands can join social movements. The brand partnered with Sierra Club to encourage cities to commit to going 100 percent renewable. The campaign is a call to action for consumers to encourage their local mayors to join 70 plus cities that have committed to sustainable energy. What's more, Seventh Generation operates its business out of Burlington, Vermont. Burlington was the first city to power its electricity needs from renewable sources. In short, using the brand to advance a social cause is crucial to marrying purpose and profit.

14.4 The Foundations of Ethical Behavior

The broad foundations of ethical behavior depend on three levels of moral development:

- Preconventional
- Conventional
- Postconventional

Preconventional level

Level 1, where children learn what is right and wrong but do not necessarily understand why their behavior is right or wrong.

Conventional level

Level 2 where we learn role conformity, first from our peers including parents, then societal laws. One could argue that company codes of conduct are also part of the conventional level of behavior in the narrow context of a company rather than a society.

Postconventional

Level 3 the post-conventional where individuals internalize moral behavior, not because they are afraid of sanctions, but because they truly believe such behavior is right.

Here we need to address an important question that why do companies care about ethical behavior?

From a business standpoint, ethical behavior can be instrumental in achieving one or both of two possible objectives:

- To develop a competitive advantage
- To avoid being perceived as irresponsible

First, some argue that responsible behavior contributes to strategic and financial success because it fosters trust, which in turn encourages commitment. For instance, the GE Ecomagination program reflects the top manager's belief that by actively responding to social concerns about global warming.

The Legal Foundations of Ethical Behavior

Legal foundations for ethical behavior can provide guidance.Legal justification is more rooted in moral reasoning and moral behavior than in the (right vs. wrong behavior) approach.However, there are good reasons to consider law as the foundation of ethical behavior. Another concern is whose law takes precedence. Should MNE worry about local laws, or do they have to worry about the laws of the country where their headquarters are located?

Because if we talk about a country's legal system as the fundamental institution that creates a comprehensive legal network to regulate social interaction; its purpose is to stabilize political and social environments as well as to ensure a fair, safe, and efficient business environment.

According to the legal argument, an individual or company can do anything that is not illegal, however, there are five good reasons why this is inadequate:Some unethical things are not illegal. Some forms of interpersonal behavior, for example, can be wrong even if they are not against the law. The law is slow to develop in emerging areas, and it takes time to pass and test laws in the courts. Moreover, because laws essentially respond to issues that have already surfaced, they cannot always anticipate dilemmas that will arise in the future.The law is often on imprecisely defined moral concepts that cannot be separated from the legal concepts they underpin.

The laws often need to undergo scrutiny by the courts. This is especially true of case law, in which the courts create law by establishing precedent.The law simply is not very efficient. "Efficiency" in this case implies achieving ethical behavior at a very low cost, and it would be impossible to solve. Every ethical behavioral problem with applicable law.In Contrast, there are also several good reasons for using the law to justify ethical behavior.

The law embodies many of a country's moral principles, making it an adequate guide for proper conduct.The law provides a clearly defined set of rules, and following it at least establishes a good precedent for acceptable behavior.The law contains enforceable rules that apply to everyone.The law is a good basis for ethical behavior because it embodies local cultural values.

Corruption and Bribery

The determinants of corruption include cultural, legal, and political forces.Bribery of public officials takes place to obtain government contracts or to get officials to do what they should be doing anyway. Let us consider an example to understand this well.

Aircel- Maxis Case (India)

In 2006, Maxis had taken over Aircel by acquiring a 74% stake. The Aircel-Maxis deal had come under the scanner in 2011 when Aircel owner C Sivasankarancomplained with the Central Bureau of Investigation (CBI) alleging he had been pressured to sell his stake to Maxis. Sivasankaran also alleged that former Union minister Dayanidhi and his industrialist brother Kalanithi received kickbacks in the form of Maxis group's investments (through the Astro network) in Sun TV Network, which is owned by the Maran family.

BJP leader and advocate Subramanian Swamy had alleged that a company controlled by Karti Chidambaram, the son of former finance minister P Chidambaram, had in 2006 received a 5 percent stake in Aircel in return for getting Maxis to pay Rs 40 billion for 74 percent shares of Aircel.According to Swamy, Chidambaram withheld Foreign Investment Promotion Board (FIPB) clearance of the deal until his son received the five-percent share in Sivasankaran's company. The above example reflects the instances of corruption and bribery.

Let us consider another example here of Walmart

Walmart paid fine in the USA for bribery charges in India and other countries (2019)

The investigations pertained to Walmart's operations before 2011, investigation concluded that Walmart allegedly allowed subsidiaries in Brazil, China, India, and Mexico to employ third-party intermediaries who paid government officials. Walmart has pleaded guilty in a seven-year-long case that accused the world's largest retailer of bribing officials in four countries namely India, China, Mexico, and Brazil to secure permits for its businesses. The Arkansas-based retailer was asked to pay $282.7 million in fines to settle the case with the US Department of Justice (DOJ) and Securities and Exchange Commission (SEC).

The period in question in India's case – 2009-2011 -- refers to the time when Walmart had a joint venture with Bharti Enterprises to operate wholesale cash and carry stores with an eye on operating retail stores in the future. The five-year-old joint venture ended in 2013 as the government never allowed foreign direct investment in multi-brand retail and the wholesale business floundered.The investigations found serious lapses in the company's internal controls which violated the US Foreign Corrupt Practices Act.

In numerous instances, senior Walmart employees knew of failures of its anti-corruption-related internal controls involving foreign subsidiaries, and yet Walmart failed for years to implement sufficient controls comporting with U.S. criminal laws, the improper payments were falsely recorded in Walmart's joint venture's books and records with vague descriptions like "misc fees," "miscellaneous," "professional fees," "incidental" and "government fee."

The release pointed out that because Walmart failed to implement sufficient internal accounting controls related to anti-corruption, from 2009 until 2011, Walmart's operations in India were able to retain third-party intermediaries that madeimproper payments to government officials to obtain store operating permits and licenses.

As part of the resolution, Walmart entered into a non-prosecution agreement with the DOJ. The DOJ will not prosecute the company if, for three years, the company meets its obligations outlined in the agreement. So, Multinational enterprises need to keep such things in the notice before entering into such practices as results would be detrimental for the companies.

Why mining in India is a source of corruption (2011)

The Orissa state produces about 45 million tonnes of iron ore a year and exports more than half of it to China. It is not the only state in India where mining has become a controversial trade.South Korean company Posco's planned to build a $12bn steel plant - India's largest foreign investment project - in the eastern state of Orissa. The project ran into heavy weather over how much iron ore it should be allowed to export. Another issue was of acquiring land from the farmers for the plant in the state

Why has mining become a source of massive corruption in India? For one, India is rich in lucrative minerals. It is the world's largest producer and exporter of mica, the third-largest producer of coal, and the second-largest producer of barites.India is also the world's fourth, fifth and seventh-largest producer of iron ore, bauxite, and manganese respectively. Some of the most mineral-rich parts of the country are situated in regions that are home to some of the poorest tribal communities.Over the last two decades, India has opened mining to private companies without strong and independent regulation.

Legal and regulatory loopholes and inadequate policing has allowed the illegal mining operations to flourish and grow so much so an ombudsman report on mining in Karnataka found that the promoters of privately owned mining companies in the Ballery region, where most of the mines are located - paid off politicians, and then joined politics themselves, rising to positions in the state government.

No wonder that for many in India, mining has come to epitomize the ugly underbelly of economic liberalization - crony capitalism and rampant loot of natural resources.The mines ministry now admits that "mining activities have resulted in little local benefit and has been at the cost of environmental degradation".Now the government plans to amend a 54-year-old law to make it mandatory for mining companies to put in place rehabilitation and resettlement programs for the people affected by their activities and protect the environment.

Summary

Social responsibility in business, also known as corporate social responsibility (CSR), pertains to people and organizations behaving and conducting business ethically and with sensitivity towards social, cultural, economic, and environmental issues.

Ethics can be defined as a system of moral standards or values. A sense of ethics is determined by several social, cultural, and religious factors.

Greenwashing is the process of conveying a false impression or providing misleading information about how a company's products are more environmentally sound.

The broad foundations of ethical behavior depend on three levels of moral development:Preconventional, Conventional, and Postconventional.

Keywords

Triple bottom line: It aims to measure the financial, social, and environmental performance of a company over time.

Ethics: It can be defined as a system of moral standards or values. A sense of ethics is determined by several social, cultural, and religious factors.

Greenwashing: It is the process of conveying a false impression or providing misleading information about how a company's products are more environmentally sound.

Self Assessment

Multiple-Choice questions

1. The triple bottom line aims to measure the financial, _________, and environmental performance of a company over time.

A. Profit

B. Economic

C. Social

D. Planet

2. Which of the following is NOT a key stakeholder group that a company must work to satisfy to survive in a global environment?

A. employees

B. competitors

C. shareholders

D. customers

3. An important business objective for pursuing ethical behavior is to create a better relationship with corrupt politicians and customers.

A. True

B. False

4. Under the practice of extraterritoriality, legal and ethical values in a country may cause its companies to operate abroad according to home country laws rather than host country laws.

A. True

B. False

5. Which of the following is not a source of work-related pressures in the global supply chain?

A. Consumers

B. Trade Unions

C. Media

D. Leading indicators

6. Which of the following statements is most likely true about the post-conventional level of moral development?

A. Individuals learn what is moral but not why such behavior is moral.

B. Individuals behave morally because they fear negative repercussions.

C. Individuals learn how to conform to society's values through observation.

D. Individuals behave morally because they believe such actions are right.

7. Encouraging ethical behaviorto develop competitive advantages will most likely result in all of the following for a firm EXCEPT ________.

A. strategic accomplishment
B. consumer commitment
C. industry resolutions
D. financial success

8. Which of the following most likely complicates ethical behavior for firms that expand overseas?
A. local laws and values
B. expatriate management
C. unstable financial settings
D. international codes of conduct

9. Ethical dilemmas tend to be ________ for MNE managers than for domestic managers.
A. more complicated
B. less controversial
C. easier to decide
D. less common

10. Which of the following is a reason for an MNE to base its standards for ethical behavior on a country's laws?
A. The law embodies many of a country's moral beliefs but is an inadequate guide for proper conduct.
B. The law contains unenforceable rules that are impossible for society to follow.
C. The law represents a consensus derived from significant deliberation.
D. The law is based on precisely defined moral concepts.

11. Which of the following is NOT one of the issues surrounding high levels of bribery and corruption?
A. high poverty rates
B. regional conflict
C. political unrest
D. high per capita income

12. Which level of moral development involves an individual learning role-conformity from peers, parents, and laws?
A. conventional
B. principled
C. autonomous
D. preconventional

13. Which of the following best supports the idea that MNEs should remain in countries that allow child labor?
A. MNEs have a positive influence on government employment policies in most foreign countries.
B. Many MNEs have substantially improved the working conditions of their foreign plants.
C. MNEs are required to pay child workers more than local companies.
D. Most MNEs employ local managers to handle cultural differences.

14. Which of the following best explains Nike's quick response to criticism of unfair employment practices in developing countries?
A. retaining employees
B. improving public relations
C. addressing product safety concerns
D. cutting costs in order to improve profits

15. Governmental agencies and nongovernmental organizations monitor the behavior of companies and their employees to ensure that laws are being followed.

A. True
B. False

Answer for self Assessment

1.	C	2.	B	3.	B	4.	A	5.	D
6.	D	7.	C	8.	A	9.	A	10.	C
11.	D	12.	A	13.	B	14.	B	15.	A

Review Questions

1.Explain why the argument that "anything legal is ethical" is insufficient.

2. How have sustainability demands affected international business?

3. What ethical and labor-related issues are a major challenge to MNEs that operate in developing countries?

4. How can an MNE operating in a developing country have a positive influence on labor policies? Illustrate your answer with an example.

5. What motivations do companies have to act responsibly? How can codes of conduct help firms to act ethically?

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