INTERNATIONAL BUSINESS

M.Com., (Accountancy)

Semester – III, Paper-V

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FOREWORD

Since its establishment in 1976, Acharya Nagarjuna University has been forging a head in the path of progress and dynamism, offering a variety of courses and research contributions. I am extremely happy that by gaining 'A' grade from the NAAC in the year 2016, Acharya Nagarjuna University is offering educational opportunities at the UG, PG levels apart from research degrees to students from over 443 affiliated colleges spread over the two districts of Guntur and Prakasam.

The University has also started the Centre for Distance Education in 2003-04 with the aim of taking higher education to the door step of all the sectors of the society. The centre will be a great help to those who cannot join in colleges, those who cannot afford the exorbitant fees as regular students, and even to housewives desirous of pursuing higher studies. Acharya Nagarjuna University has started offering B.A., and B.Com courses at the Degree level and M.A., M.Com., M.Sc., M.B.A., and L.L.M., courses at the PG level from the academic year 2003-2004onwards.

To facilitate easier understanding by students studying through the distance mode, these self-instruction materials have been prepared by eminent and experienced teachers. The lessons have been drafted with great care and expertise in the stipulated time by these teachers. Constructive ideas and scholarly suggestions are welcome from students and teachers involved respectively. Such ideas will be incorporated for the greater efficacy of this distance mode of education. For clarification of doubts and feedback, weekly classes and contact classes will be arranged at the UG and PG levels respectively.

It is my aim that students getting higher education through the Centre for Distance Education should improve their qualification, have better employment opportunities and in turn be part of country's progress. It is my fond desire that in the years to come, the Centre for Distance Education will go from strength to strength in the form of new courses and by catering to larger number of people. My congratulations to all the Directors, Academic Coordinators, Editors and Lesson-writers of the Centre who have helped in these endeavors.

Prof. P. RajaSekhar
Vice-Chancellor
Acharya Nagarjuna University

Semester – III
305CO21: INTERNATIONAL BUSINESS
Paper-V
SYLLABUS

1. **International Business:**

   Role and Process: Introduction International Business (Trade) Theories.

2. **Strategic Management:**

   Designing Appropriate Structure Strategic Planning in MNCs Strategic Considerations.

3. **Control and Evaluation:**

   Introduction and Control Systems Measurement and Evaluation of Performance Multinational Corporate Culture.

4. **Management Process and Practice:**

   Human Resource Management in MNCs International Production land Logistics Negotiations in International Business.

5. **Multilateral Arrangements:**

   International Business LDCs Regional Trade Grouping and Cooperation Role of International Organisations Multilateral (Negotiated) Agreements.

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LESSON -1

INTRODUCTION TO INTERNATIONAL BUSINESS

OBJECTIVES

- ✓ To Enumerate the concept of international business
- ✓ To Analyse the evolution of international business
- ✓ To Discuss the drivers of globalization
- ✓ To Describe the stages of internationalization
- ✓ To Explain the difference between domestic and international business
- ✓ To Discuss the approaches of international business

STRUCTURE

1.1 Introduction
1.2 Evolution of International Business
1.3 History of international business starts with the evolution of human civilization
1.4 Drivers of Globalization
1.5 Influences of International Business
1.6 Growth of Overseas Markets
1.7 Stages of Internationalization
1.8 Patterns of Expansion
1.9 Characteristics of a Transnational Company
1.10 Differences between Domestic and International Business
1.11 International Business Approaches
1.12 Advantages of International Business
1.13 summary
1.14 Key words
1.15 Self Assessment questions
1.16 Suggested Readings

1.1 INTRODUCTION

One of the most dramatic and significant world trends in the past two decades has been the rapid, sustained growth of international business. Markets have become truly global for most goods, many services, and especially for financial instruments of all types. World product trade has expanded by more than 6 percent a year since 1950, which is more than 50 percent faster than growth of output the most dramatic increase in globalization, has occurred in financial markets. In the global forex markets, billions of dollars are transacted each day, of which more than 90 percent represent financial transactions unrelated to trade or investment. Much of this activity takes place in the so-called Euromarkets, markets outside the country whose currency is used. This pervasive growth in market interpenetration makes it increasingly difficult for any country to avoid substantial external impacts on its economy. In particular massive capital flows can push exchange rates away from levels that accurately reflect competitive relationships among nations if national economic policies or performances diverse in short run.

The rapid dissemination rate of new technologies speeds the pace at which countries must adjust to external events. Smaller, more open countries, long ago gave up illusion of domestic policy autonomy. But even the largest and most apparently self-contained economies, including the US, are now significantly affected by the global economy. Global integration in trade, investment, and factor flows, technology, and communication has been tying economies together. Why then are these changes coming about, and what exactly are they? It is in practice, easier to identify the former than interpret the latter. The reason is that during the past few decades, the emergence of corporate empires in the world economy, based on the contemporary scientific and technological developments, has led to globalization of production. As a result of international production, co-operation among global productive units, the large-scale capital exports, “the export of production” or “production abroad” has come into prominence as against commodity export in world economy in recent years.

Global corporations consider the whole of the world their production place, as well as their market and move factors of production to wherever they can optimally be combined. They avail fully of the revolution that has brought about instant worldwide communication, and near instant-transformation. Their ownership is transnational; their management is transnational. Their freely mobile management, technology and capital, the modern agent for stepped-up economic growth, transcend individual national boundaries. They are domestic in every place, foreign in none-a true corporate citizen of the world. The greater interdependence among nations has already reduced economic insularity of the peoples of the world, as well as their social and political insularity.

International business includes any type of business activity that crosses national borders. Though a number of definitions in the business literature can be found but no simple or universally accepted definition exists for the term international business. At one end of the definitional spectrum, international business is defined as 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
In its traditional form of international trade and finance as well as its newest form of multinational business operations, international business has become massive in scale and has come to exercise a major influence over political, economic and social from many types of comparative business studies and from knowledge of many aspects of foreign business operations. In fact, sometimes the foreign operations and the comparative business are used as synonymous for international business. Foreign business refers to domestic operations within a foreign country. Comparative business focuses on similarities and differences among countries and business systems for focuses on similarities and differences among countries and business operations and comparative business as fields of enquiry do not have as their major point of interest the special problems that arise when business activities cross national boundaries.

1.2 EVOLUTION OF INTERNATIONAL BUSINESS

The business across the borders of the countries had been carried on since times immemorial. But, the business had been limited to the international trade until the recent past. The post-World War II period witnessed an unexpected expansion of national companies into international or multinational companies. The post 1990's period has given greater fillip to international business.

In fact, the term international business was not in existence before two decades. The term 'international business' has emerged from the term 'international marketing', which, in turn, emerged from the term 'export marketing'. International Trade to International Marketing: Originally, the producers used to export their products to the nearby countries and gradually extended the exports to far-off countries. Gradually, the companies extended the operations beyond trade Example: India used to export raw cotton, raw jute and iron ore during the early 1900s. The massive industrialization in the country enabled us to export jute products, cotton garments and steel during 1960s.

India, during 1980s could create markets for its products, in addition to mere exporting. The export marketing efforts include creation of demand for Indian products like textiles, electronics, leather products, tea, coffee etc., arranging for appropriate distribution channels, attractive package, product development, pricing etc. This process is true not only with India, but also with almost all developed and developing economies.

International Marketing to International Business: The multinational companies which were producing the products in their home countries and marketing them in various foreign countries before 1980s started locating their plants and other manufacturing facilities in foreign/host countries. Later, they started producing in one foreign country and marketing in other foreign
countries.

Example: Unilever established its subsidiary company in India, i.e., Hindustan Lever Limited (HLL), HLL produces its products in India and markets them in Bangladesh, Sri Lanka, and Nepal etc. Thus, the scope of the international trade is expanded into international marketing and international marketing is expanded into international business.

1.3 HISTORY OF INTERNATIONAL BUSINESS STARTS WITH THE EVOLUTION OF HUMAN CIVILIZATION

The integration and growth of economies and societies was the main reason for the first phase of international business and globalization.

19th Century: Broader concept of the integration of economies and societies
1870: Began first phase of Globalization
1919: World War II: End of first phase of Globalization, Industrial revolution in UK,
Germany and the USA Sharp increase in the trade with import and export by colonial empires
1913: GDP 22.1: After 1913: Increased Trade Barriers to Protect Domestic Production

1930's: Declined Trade Ratio, GDP 9.1
After 1930's: World Nations felt the need for International Cooperation in global trade and balance of payments affairs
Establishment of IMF and IBRD (World Bank)
IMF: International Monetary Fund
IBRD: International Bank for Reconstruction and Development
1947: 23 countries conducted negotiations in order to prevent the protectionist policies and to revive the economies from recession aiming at establishment of World Trade organization

1947: Establishment of GATT (General Agreement on Trade and Tariffs)
1980s: efforts to convert GATT into WTO
1st Jan 1995: GATT was replaced by WTO (World Trade Organization)

Trade Liberalization
1990 – 2000: The Term IB (International Business) has emerged from the term International

Marketing.
There are two Phases of the evolution of the term International Business
1. International Trade to International Marketing
2. International Marketing to International Business
z After 1990: Rapid Internationalization ad globalization
Today: Interpreting the PESTIN factors of International Trade environment more clearly

1.4 DRIVERS OF GLOBALIZATION

We have discussed the nature of international business and the precautions that the multinational companies should take while operating in foreign countries. The basic question of "why do the businesses firms of a country go to other countries?" might have been in your minds. Therefore, the answer to this question, before proceeding further:

To Achieve Higher Rate of Profits

Principles and Practice of Management, Managerial Economics and Financial Management That the basic Objective of the business firms is to earn profits, business firms search for foreign markets which promise for higher rate of profits. For example, Hewlett Packard earned 85.4% of its profits from the foreign markets compared to that of domestic markets in 1994. Apple earned US$390 million as net profit from the foreign markets and only US $310 millions as net profit from its domestic market in 1994.

Expanding the Production Capacities Beyond the Demand of the Domestic Country

Some of the domestic companies expanded their production capacities more than the demand for the product in the domestic countries. These companies, in such cases, are forced to sell their excess production in foreign developed countries. Toyota of Japan is an example.

Severe Competition in the Home Country

The countries oriented towards market economies since 1960s had severe competition from other business firms in the home countries. The weak companies which could not meet the competition of the strong companies in the domestic country started entering the markets of the developing countries.

Limited Home Market

When the size of the home market is limited either due to the smaller size of the population or due to lower purchasing power of the people or both, the companies internationalize their operations.

Example: Most of the Japanese automobile and electronic firms entered US, Europe and even African markets due to the smaller size of the home market. ITC entered the European market due to the lower purchasing power of the Indians with regard to high quality cigarettes.

Similarly, the mere six million population of Switzerland is the reason for Ciba-Geigy to internationalize its operations. In fact, this company was forced to concentrate on global market and establish manufacturing facilities in foreign countries.

Political Stability vs. Political Instability:

Political stability does not simply mean that continuation of the same party in power, but it does mean that continuation of the same policies of the Government for a quite longer period. It is viewed that USA is a politically stable country. Similarly, UK, France, Germany, Italy and Japan are also politically stable countries. Most of the African countries and some of the Asian countries like Malaysia, Indonesia, Pakistan and India are politically instable countries. In fact, business firms shift their operations from politically instable countries into politically stable countries.

Availability of Technology and Managerial Competence:

Availability of advanced technology and managerial competence in some countries act as pulling factors business firms from home country. Companies from the developing world are attracted by the developed countries due to these reasons. In fact, American Companies, in recent years, depend on Japanese companies for technology and management expertise.

The drivers of globalization can be classified into.

1. Market Drivers:

(a) Per capita income converging among industrialized nations
(b) Convergence of lifestyles and tastes
(c) Organizations beginning to behave as global consumers
(d) Increasing travel create global consumers

(e) Growth of global and regional channels
(f) Establishment of world brands
(g) Push to develop global advertising

2. Cost Drivers:

(a) Continuing push for economies of scale
(b) Accelerating technological innovation
(c) Advances in transportation
(d) Emergence of newly industrialized countries with productive capability and low labour costs
(e) Increasing cost of product development relative to market life

3. Government Drivers:

(a) Reduction of tariff barriers
(b) Reduction of non-tariff barriers
(c) Creation of blocs
(d) Decline in role of governments as producers and consumers
(e) Privatization in previously state-dominated economies
(f) Shift to open market economies from closed communist systems in eastern Europe

4. Competitive Drivers:

(a) Continuing increases in the level of world trade
(b) Increased ownership of corporations by foreign acquirers
(c) Rise of new competitors' intent upon becoming global competitors
(d) Growth of global networks making countries interdependent in particular industries
(e) More companies becoming globally centered rather than nationally centered
(f) Increased formation of global strategic alliances

5. Other Drivers:

(a) Revolution in information and communication
(b) Globalization of financial markets
(c) Improvements in business travel

1.5 INFLUENCES OF INTERNATIONAL BUSINESS

Because most of the countries are not as fortunate as the 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 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 matter of choice when survival is at stake. However, only firms with previously substantial market share and international experience could expand successfully.

1.6 GROWTH OF OVERSEAS MARKETS

Developing countries, in spite of economic and marketing problems, are excellent markets. According to a report prepared for the U.S. CONGRESS by the U.S. trade representative, Latin America and Asia/Pacific are experiencing the strongest economic growth. American markets cannot ignore the vast potential of international markets. The world is more than four times larger than the U.S. market. In the case of Amway corps., a privately held U.S. manufacturer of cosmetics, soaps and vitamins, Japan represents a larger market than the India.

Sales and Profit

Foreign markets constitute a larger share of the total business of many firms that have wisely cultivated markets aboard. Many large U.S. companies have done well because of their overseas customers. IBM and Compaq, foe ex, sell more computers aboard than at home. According to the US dept. of commerce, foreign profits of American firms rose at a compound annual rate of 10% between 1982 and 1991, almost twice as fast as domestic profits of the same companies.

Diversification

Demand for mast products is affected by such cyclical factors as recession and such seasonal factors as climate. The unfortunate consequence of these variables is sales fluctuation, which can frequently be substantial enough to cause lay offs of personnel. One way to diversify a companies' risk is to consider foreign markets as a solution for variable demand. Cold weather, for instance may depress soft drink consumption. Yet not all countries enter the winter season at the same time, and some countries are relatively warm year round. Bird, USA, inc., a Nebraska manufacturer of go carts, and mini cars, for promotional purposes has found that global selling has enabled the company to have year round production. It may be winter in Nebraska but its summer in the southern hemisphere – somewhere there is a demand and that stabilizes the business.

Inflation and Price Moderation

The benefits of export are readily self-evident. Imports can also be highly beneficial to a country because they constitute reserve capacity for the local economy. Without imports, there is no incentive for domestic firms to moderate their prices. The lack of imported product alternatives forces consumers to pay more, resulting in inflation and excessive profits for local firms. This development usually acts as prelude to workers demand for higher wages, further exacerbating the problem of inflation.

Import quotas imposed on Japanese automobiles in the 1980's saved 46200 US production jobs but at a cost of $160,000 per job per year. This cost was a result of the addition of $400 to the prices of US cars, and $1000 to the prices of Japanese imports. This windfall for

Detroit resulted in record high profits for US automakers. Not only do trade restrictions depress price competition in the short run, but they also can adversely affect demand for year to come.

Caution Demand for most products is easily to be fluctuated by occurrence of any cyclical or seasonal factors pertaining like recession or climate.

Employment

Trade restrictions, such as high tariffs caused by the 1930's Smoot-Hawley bill, which forced the average tariff rates across the board to climb above 60%, contributed significantly to the great depression and have the potential to cause wide spread unemployment again. Unrestricted trade on the other hand improves the world's GNP and enhances employment generally for all nations. Importing products and foreign ownership can provide benefits to a nation. According to the institute for international economics – a private, non-profit research institute – the growth of foreign ownership has not resulted in a loss of jobs for Americans; and foreign firms have paid their American workers the same, as have domestic firms

Standards of Living

Trade affords countries and their citizen's higher standards of living than other wise possible. Without trade, product shortages force people to pay more for less, products taken for granted, such as coffee and bananas may become unavailable overnight. Life in most countries would be much more difficult were it not for the many strategic metals that must be imported. Trade also makes it easier for industries to specialize and gain access to raw materials, while at the same time fostering competition and efficiency. A diffusion of innovations across national boundaries is useful by-products of international trade. A lack of such trade would inhibit the flow innovative ideas.

The 1990s and the new millennium clearly indicate rapid internationalization and globalization. The entire globe is passing at a dramatic pace through the transition period. Today the international trader is in a position to analyze and interpret the global social, technical, economic, political and natural environmental factors more clearly.

Conducting and managing international business operations is a crucial venture due to variations in political, social, cultural and economic factors, from one country to another country.

Example: Most of the African consumers prefer high quality and high priced products due to there higher ability to buy.

Therefore, the international businessman should produce and export less costly products to most of the African countries and vice versa to most of the European and North American countries. High priced Palmolive soaps are exported and marketed in developing countries like Ethiopia, Pakistan, Kenya, India, Cambodia etc.

International business houses need accurate information to make an appropriate decision. Europe was the most opportunistic market for leather goods and particularly for shoes. Bata based on the accurate data could make appropriate decision to enter various European countries. International business houses need not only accurate but timely information. Coca-Cola could enter the European market based on the timely information, whereas Pepsi entered later. Another example is the timely entrance of Indian Software companies also made timely decision in the case of Europe.

The size of the international business should be large in order to have impact on the foreign economies. Most of the multinational companies are significantly large in size. In fact, the capital of some of the MNCs is more than our annual budget and GDPs of the some of the African
countries.

Most of the international business houses segment their markets based on the geographic market segmentation. Daewoo segmented its market as North America, Europe, Africa, India sub-continent and Pacific market.

International markets present more potentials than the domestic markets. This is due to the fact that international markets are wide in scope, varied in consumer tastes, preferences and purchasing abilities, size of the population etc.

Example: IBM's sales are more in foreign countries than in USA. Similarly, Coca-Cola sales, Procter and Gamble's sales and Satyam Computer's Sales are more in foreign countries than in their respective home countries.

1.7 STAGES OF INTERNATIONALIZATION

Internationalization process for a company is a complex process. The experts have discussed various strategies that are generally adopted in the process of internationalization. The optimal strategic attractive available to firms depend upon different levels of internationalization. Although there are variations in how international operations evolve, some overall patterns have been noted. Most of these patterns relate to risk minimization behaviour. In other words, most companies view foreign operations as riskier than domestic ones because they must operate in environments which are less familiar to them. Thus, they initially undertake international activities reluctantly and follow practices to minimize their risks. But as they learn more about foreign operations and experience success with them, they move to deeper foreign commitments that now seem less risky to them.

1.8 PATTERNS OF EXPANSION

The farther a company moves from the center on any axis, the deeper its international commitment becomes. However, a company does not necessarily move at the same speed along each axis. A slow movement along one axis may free up resources that allow faster expansion along another.

For example, a company may lack initial capacity to own facilities wholly in multiple foreign countries; thus it may choose either to limit its foreign capital commitment by moving slowly along axis C in order to move rapidly along axis D (to multiple foreign countries), or vice versa.

1. Passive to Active Expansion – Path A

The impetus of strategic focus is shown on axis A in Figure 1.1. Most new companies are established in response to observed domestic needs, and they frequently think only of domestic opportunities until a foreign opportunity is presented to them.

For example, companies commonly receive unsolicited export rejects because someone has already seen or heard of their products. Often these companies have no idea of how their products became known abroad.

But at this juncture, they must make a decision to export or not. Many decide not to because they fear they will not be paid or they know too little about the mechanics of foreign trade. Those that do fulfill the unsolicited export orders and then see that opportunities are available to them abroad are apt later to seek out other markets to sell their goods. Even large companies may move from passive to active involvement with aspects of their business.

For example, although Tokyo Disneyland was proposed by a group of Japanese businessmen, the success of that venture led Disney to actively seek out a European location or another park.

2. External to Internal Handling of Operations – Path B

The use of intermediaries to handle foreign operations is common during early stage of international expansion because this method may minimize risk of committing one's own resources to international endeavours and also because of reliance on another company that already knows how to operate in foreign environments.

But if the business grows successfully, the company will usually be more willing to handle the operations with its own staff. This is because it has learned more about foreign operations, sees them as being less risky than at the onset, and realizes the volume of business justifies the development of internal capabilities by hiring additional trained personnel, for purposes such as to maintain a department to carry out foreign sales or purchases. This evolution is shown on axis B in Figure 1.1

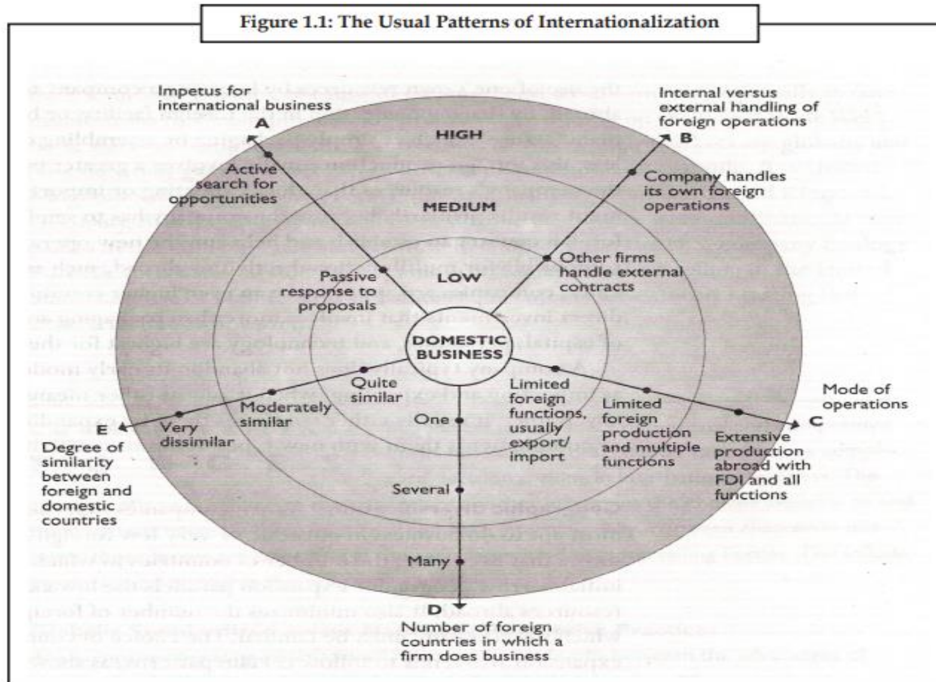

Figure 1.1: The Usual Patterns of Internationalization

Deepening Mode of Commitment – Path C:

Axis C in Figure 1.1 shows that importing or exporting is usually the first type of foreign operation a company undertakes. At an early stage of international involvement, importing or exporting requires the least commitment and the least risk to the company's resources such as capital, personnel, equipment, and production facilities.

For example, a company could engage in exporting by using excess production capacity to produce more goods which then would be exported. By doing this, it would limit its need to invest more capital in additional production facilities such as plants and machinery. Further, the engagement of only importing and exporting limits the functions with which the company is responsible abroad.

For example, it does not have to manage a foreign work force. Companies often move into some type of foreign production after successfully building exports to that market. Initially this foreign production is apt to minimize the use of one's own resources by licensing, by sharing ownership in the foreign facility, or by limiting the amount of manufacture such as simply packaging or assembling output abroad.

Nevertheless this foreign production usually involves a greater international commitment of the company's resources than does exporting to importing. The greater commitment results primarily because the company has to send qualified technicians to the foreign country to establish and help run the new operations. Further, it must be responsible for multifunctional activities abroad, such as sales and production. Later, companies are apt to make an even higher commitment through foreign direct investments that involves more than packaging and assembly. Their infusion of capital, personnel, and technology are highest for these operations. A company

typically does not abandon its early modes of operating abroad, such as importing and exporting, when it adopts other means of operating internationally. Rather, it usually continues them by expanding its trade to new market or complements them with new types of business activities.

3. Geographic Diversification – Path D:

When companies first move internationally, they have one or very few foreign locations. Axis D in Figure l.1 shows that overtime, the number of countries in which they operate increases. The initial narrow geographic expansion parallels the low early commitment of resources abroad. It also minimizes the number of foreign environments with which the company must be familiar.

Initially, companies tend to go to those locations that are geographically close and/or perceived to be similar. There is also a perception of less risk because of greater familiarity with nearby areas and because of a perception of similarity of environments because of common languages and levels of economic development. Later, companies move to more distant countries, including those that are perceived to have less similar environments to those found in home country.

4. Leapfrogging of Expansion – Path E

The patterns that most companies have followed in their international expansion are not necessarily optimal for their long range performance. Example: The initial movement into a nearby country, like movement by a US company into Canada, may delay entry into faster growing markets, such as some of those in Southeast Asia. There is, however, evidence that many new companies are starting out with a global focus.

Normally the following stages of internationalization can be followed as:

Stage 1 – Domestic Company: Domestic Company limits its operations, mission and vision to the national political boundaries. These companies focus its view on the domestic market opportunities, domestic suppliers, domestic financial companies, domestic customers etc. These companies analyze the national environment of the country, formulate the strategies to exploit the opportunities offered by the environment.

Stage 2 – International Company: These companies select the strategy of locating the branch in the foreign market and extend the same domestic operations into foreign markets. These companies remain ethnocentric or domestic country oriented. Normally internalization process of most of the global companies starts with this stage of two processes. Many of the companies follow this strategy due to limited resources and also to learn from the foreign market gradually before becoming a global company without much risk.

Stage 3 – Multinational Company: This stage of multinational company is also referred as multidomestic company formulates different strategies for different market, thus the orientation shift from ethnocentric to polycentric. Under polycentric orientation the offices/branches/ subsidiaries of a MNC work like a domestic company in each country where they operate with

distinct policies and strategies suitable to that country concerned.

Stage 4 – Global Company: Global company is the one which has either produces in home country or in a single country and focuses on marketing these products globally and focuses on marketing these products domestically.

Stage 5 – Transnational Company: Transnational company produces, market, invests and operate across the world. It is an integrated global enterprise which links global resources with global market at profits. There is no such pure transnational corporation.

1.9 CHARACTERISTICS OF A TRANSNATIONAL COMPANY

This company thinks globally and acts locally. This company adopts global strategy but allow 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 economic, political, social and cultural and technological environment. These companies collect and scan the information regardless 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, threat 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.

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

Extension: Some products do not require any change when they are marketed in other countries. Their market is just extension.

Example: Transnational companies create their global brand extending the product to the new market. Rothmans cigarette extended its products in many Europeans and African countries.
HRM policy: It selects the best human resource and develops them regardless nationality, ethnic group.

Purchasing: Transnational company procures world class material from the best source across the globe

1.10 DIFFERENCES BETWEEN DOMESTIC AND INTERNATIONAL BUSINESS

Difference between domestic trade and foreign trade and their peculiar problems. Trade, no doubt, implies exchange of goods between persons, but there are marked differences between domestic trade and international trade. The differences and the complications arise therein are as follows:

1. Distance: The distance involved in export of goods in external trade is generally greater Than on the domestic trade.

2. Language differences: There are differences in the languages of the nations of the world. The overseas traders should be very careful in preparing the publicity material in the languages of the trading country.

3. Cultural difference: A producer should have full knowledge about the market of his products. For exporting goods particularly a thorough research is undertaken.

4. Technical difference: In the national market the difference in the technical specification for goods and their requirements is not wide.

5. Tariff barriers: In the national trade, there are no custom duties, exchange restrictions, fixed quotas or other tariff barriers.

6. Documentations: In the home trade there are few documents involved in the exchange of Goods Payments: In the internal trade, the goods are exchanged in the currency unit of the country. In case of foreign trade currencies differ widely throughout the world and those also vary in value.

7. Transport and insurance cost: The transport and insurance costs are less in case of domestic trade. For the exports, on the other hand the cost of transport is high and the insurance is complicated.

1.11 INTERNATIONAL BUSINESS APPROACHES

In truth, we have become part of a global village and have a global economy where no organization is insulted from the effects foreign markets and competition. Indeed, more and more firm are reshaping themselves for international competition and discovering new ways to exploit markets in every corner of the world. Failure to take a global perspective in one of the biggest mistakes managers can make. Thus we start laying the foundation for our discussion by introducing and describing the basic of international business.

An international business is one that is based primarily in a single country but acquires some meaningful share of its resources or revenues (or both) from other countries. Sears fits this description. Most of its stores are in the United States.

Example: The retailer earns around 90 percent of its revenues from its U. S. operation with the remaining 10 percent coming sears stores in Canada. At the same time, however, many of the products it sells, such as tools and clothing are made abroad from any perspective. Then it is clear that we live in a truly global economy. Virtually all business today must be concerned with the competitive situations they face in lands for from home and with how companies from distant lands are competing in their homelands.

Douglas Wind and Pelmutter advocated four approaches of international business.

Ethnocentric Approach: The excessive production more than the demand for the product, either due to competition or due to change in customer preferences push the company to exports the excessive production to the foreign countries. The company export the same product designed for domestic market to foreign market under this approach. Thus, maintenance of domestic approach towards international business is called ethnocentric approach.

Polycentric Approach: The company establishes a foreign subsidiary company and decentralized all the operations and delegates decision making and policy making authority to its executives. The executives of the subsidiary formulate the policies and strategies, design the product based on the host country's environment and the preferences of the local customer. Thus this approach mostly focuses on the conditions of the host country in policy formulation, strategy implementation and operations.

Regiocentric Approach: The foreign subsidiary considers the regional environmental for formulating policies and strategies. It market more or less the same product designed under polycentric approach in other countries of the region, but with different market strategies.

Geocentric Approach: Under this approach, the entire world is just like a single country for the company. They select the employees from the entire globe and operate with the number of subsidiaries. Each subsidiary functions like an independent and autonomous company in formulating policies, strategies, product design, human resource policies, operations etc.

1.12 ADVANTAGES OF INTERNATIONAL BUSINESS

1. To achieve higher rate of profits:

Expanding the production capacities beyond the demand of the domestic country
Severe competition in the home country
Limited home market

2. Political stability vs. political instability:

Availability of technology and competent
Human resource
High cost of transportation
Nearness to raw materials
Availability of quality human resources at low cost
Liberalization and globalization

3. To increase market share:
To achieve higher rate of economic development
Tariffs and import quotas

4. High living standards:
Increased socio-economic welfare
Wider market
Reduced effects of business cycles
Reduced risks Large-scale economies

5. Potential untapped markets:
Provides the opportunity for and challenge to domestic business
Division of labour and specialization
Economic growth of the world
Optimum and proper utilization of world resources
Cultural transformation
Knitting the world into a closely interactive traditional village

1.13 SUMMARY

International business is all commercial transactions – 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 India.

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

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

This pervasive growth in market interpenetration makes it increasingly difficult for any country to avoid substantial external impacts on its economy.

In particular massive capital flows can push exchange rates away from levels that accurately reflect competitive relationships among nations if national economic policies or performances diverse in short run.

The rapid dissemination rate of new technologies speeds the pace at which countries must adjust to external events. Smaller, more open countries, long ago gave up illusion of domestic policy autonomy.

But even the largest and most apparently self-contained economies, including the US, are now significantly affected by the global economy.

Global integration in trade, investment, and factor flows, technology, and communication has been tying economies together.

1.14 KEY WORDS

Ethnocentric Approach: Maintenance of domestic approach towards international business.
Foreign Direct Investment: A foreign direct investment is one that gives the investor a controlling interest in a foreign company.
Geocentric Approach: Under this approach, the entire world is just like a single country for the company.
International Business: Any firm that engages in international trade or investment.
Merchandise Export: Tangible products sent out of a country.
Polycentric Approach: This approach mostly focuses on the conditions of the host country in policy formulation, strategy implementation and operations.
Regiocentric Approach: It market more or less the same product designed under polycentric approach in other countries of the region, but with different market strategies.

1.15 SELF ASSESSMENT QUESTIONS

1. Describe the concept of international business and explain its analysis.
2. What is the importance of international business?
3. Distinguish between the domestic trade and foreign trade.
4. Why companies engage in international business?
5. What are the reasons for phenomenon international growth in recent years?
6. Describe the evolution of international business.
7. Explain the drivers of globalization.

1.16 SUGGESTED READINGS

1. C.B. Gupta, Business Environment.
2. Charles W.L. Hill, International Business Competing in the Global Marketplace,
3. 4th Edition, Tata McGraw Hill, Publishing Company Limited.
4. Cherunillam Francis, International Business, Text and Cases, 3rd Edition, Prentice-Hall of India Private Limited.
5. M. Kapagam, Environmental Economics.
6. Philip R. Cateora, International Marketing.
7. Francis Cherunillam, Global Business Environment.

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LESSON -2
INTERNATIONAL TRADE THEORIES

OBJECTIVES

- ✓ To Examine theories that explain why they are beneficial for a country to engage in international trade
- ✓ To Describe the comparative advantage theory
- ✓ To Explain the product life cycle theory
- ✓ To Discuss the relative factor endowment theory

STRUCTURE

2.1 Theories of international trade
2.2 Theory of Absolute Cost Advantage
2.3 Relative Factor Endowment Theory
2.4 Country Similarity Theory
2.5 Product Life Cycle
2.6 Stages of Product Life Cycle
2.7 Summary
2.8 Keywords
2.9 Self Assessment Questions
2.10 Suggested Readings

2.1 THEORIES OF INTERNATIONAL TRADE

Mercantalism

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).

The principle assertion of Mercantilism was that 'a nation's wealth and prosperity reflects in its stock of precious metals such as, gold and silver', as at that time gold and silver, were the currency of trading nations. The basic tenet of Mercantilism is to maintain a trade balance where exports are greater than imports. Consistent with this belief, the Mercantilist doctrine advocated the government intervention. It means that their policy was to maximize exports and minimize imports. It means that imports were to be restricted, by means of tariff and quotas, whereas, exports were to be restricted by subsidies.

Criticism

1. The theory viewed trade as a zero sum game, a gain by one results 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.

2.2 THEORY OF ABSOLUTE COST ADVANTAGE

According to Adam Smith, trade between two nations is based on absolute advantage. When one nation is more efficient than (or has an absolute advantage over) another in the production of one commodity but is less efficient than (or has an absolute disadvantage with respect to) the other nations in producing a second commodity than both the nation can gain by each specializing in the production of the commodity of its absolute advantage and exchanging part of its output with the other nation for the commodity of its absolute disadvantage. By this process resources are utilized in the more efficient way and the output of both commodities will rise. According to Smith, "whether advantage which one country has over another by natural or acquired, is in this respect of no consequence".

Assumption

Adam Smith believed that all nations would gain from free trade and strongly advocated a policy of laissez faire (i.e. As little government interference with the economic system as possible) To illustrate, let there be two countries A and B having absolute differences in costs in producing a commodity each, X and Y respectively, at an absolute lower cost of production than the other.

The absolute cost differences are given below:

Country	Commodity X	Commodity Y
A	10	5
B	5	10

From the above, Country A can produce 10X or 5Y with one unit of labour and country B can produce 5X or 10Y with one unit of labour.In the above case, country A has an absolute advantage in the production of X (For 10X is greater than 5X) and country B has an absolute advantage in the production of Y (for 10Y is greater than 5Y).
This can be expressed as (10X of A)/ (5X of B) >1> (5Y of A)/ (10Y of B).

Trade between two countries will benefit both if A specializes in the production of X and B in the production of Y as is shown below:

Commodity → Country ↓	Production before trade (1)		Production after trade (2)		Gains from trade (2 - 1)	
	X	Y	X	Y	X	Y
A	10	5	20	--	+10	-5
B	5	10	--	20	- 5	+ 10
Total production	15	15	20	20	+ 5	+5

The above reveals that before trade both countries produce only 15 units each of the two commodities by applying one labour unit on each commodity. If A were to specialize in producing commodity X and use both units of labour on its total production will be 20 units of X. Similarly, if B were to specialize in the production of Y above, its total production will be 20 units of Y. The combined gain to both countries from trade will be 5 units each of X and Y.

Pitfalls

1. The theory is vague and lack clarity.
2. According to this theory, every country should be able to produce certain products at 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 absolute advantage of producing at the lowest cost any commodity, yet they participate in the international business. Thus Smith's analysis is weak and unrealistic.

According to Adam Smith, the Father of Economics, the basis of international trade was absolute cost advantage. There may be a case where a commodity can be produced by two countries, but the cost of producing the commodity in one country is absolutely lower than the cost of producing it in the other country. In such a case, the commodity will be produced in that country where the cost of production is the lowest. This is explained as follows. Suppose:

In India, 10 days of labour can produce 100 units of cotton, or
In India, 10 days of labour can produce 50 units of jute.
In Pakistan, 10 days of labour can produce 50 units of cotton, or
In Pakistan, 10 days of labour can produce 100 units of jute.

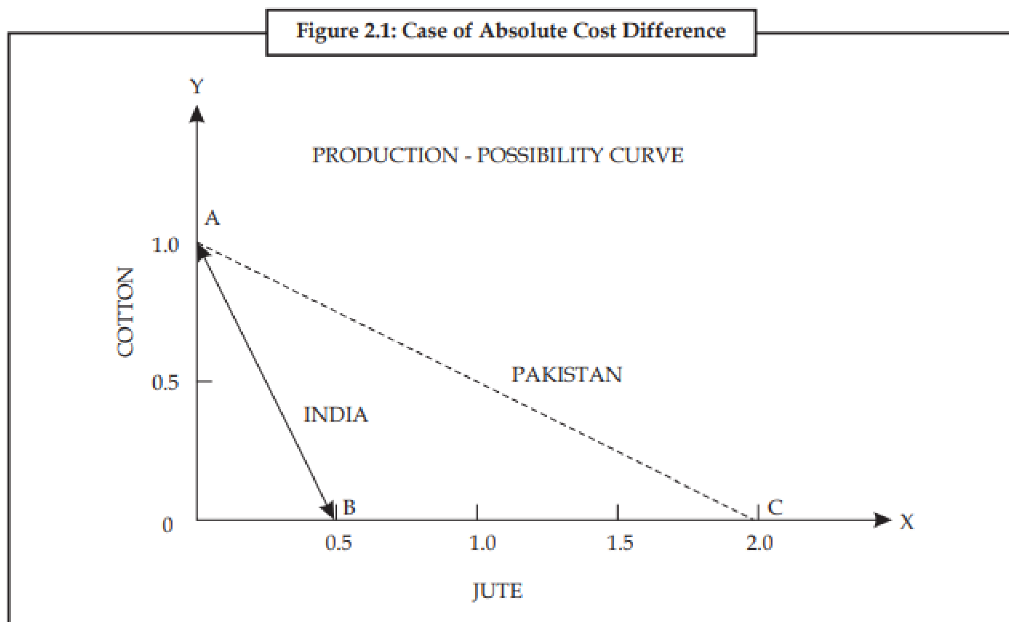
In this case, in India the same number of labour days, can produce either 100 units of cotton or 50 units of jute. The cost-ratio between cotton and jute is, 100:50 or 1 unit of cotton = 1/2 unit of jute. Similarly, in Pakistan, the cost-ratio is, 50:100 or 1/2 unit of cotton = 1 unit of jute or 1 unit of cotton = 2 units of jute.

Absolute cost differences arise, when each of the two countries can produce the commodity, at an absolutely lower production cost, than the other. In above example, India has an absolute advantage over Pakistan, in the production of cotton and Pakistan has a similar absolute advantage over India, in the production of jute. India's superiority in the production of cotton is seen by the fact that:

$$\frac{\text{100 units of cotton in India}}{\text{50 units of cotton in Pakistan}} > \frac{\text{50 units of jute in India}}{\text{100 units of jute in Pakistan}}$$

Now, if both India and Pakistan, form a part of only one country, each part will specialize in only one commodity, viz., India in the production of cotton and Pakistan in the production of jute. Division of labour between the two regions must lead to an increase in the total output. This is what exactly happens, when international trade takes place between these two countries. India will specialize in the production of cotton, export part of its output to Pakistan, as against import of jute. India will be prepared to enter into trade, so long, as it can secure more than 1/2 unit of jute for one unit of cotton (this is the cost ratio within India). Pakistan on the other hand, will be prepared to give, as much as 2 units of jute, for one unit of cotton. Hence, trade between the two countries will be very beneficial at any rate between 1/2 to 2 units of jute, for one unit of cotton. International trade will, therefore, definitely take place under conditions of an absolute difference in cost. But the trade between the two countries will not be for a long period or on a permanent basis.

Figure 2.1: Case of Absolute Cost Difference



In Figure 2.1, the production-possibility curves for India and Pakistan are prepared on the basis of 1 unit of cotton = 1/2 unit of jute and 1 unit of cotton = 2 units of jute, respectively. The line AB explains the position of India, where the distance along Y-axis i.e., OA (cotton) is double the distance along X axis, i.e., OB (jute). Similarly, line AC indicates the position of Pakistan, where the distance along Y-axis i.e., OA (cotton) is half the distance along X-axis i.e., OC (jute). BC is the amount of pure surplus, which can be distributed between the two countries, in case trade takes place. Any rate of exchange between B and C, will be beneficial to both the countries. 2.3 Comparative Cost Advantage Theory According to the Comparative Cost Theory, countries in the long run will tend to specialize in the business (production and marketing) of those goods in whose business they enjoy comparative low cost advantage and import other goods in which the countries have comparative cost disadvantage, if free trade is allowed. This specialization helps in the mutual advantage of the countries participating in international business. 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 other 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 the nations can engage in international trade when one country specializes in production in which it has greater efficiency than the other.

Assumption of the Theory

The following are the assumptions of the comparative cost advantage theory:
1. There are only two countries.
2. They produce the same two commodities.
3. There are similar tastes in both countries.
4. The only element of cost of production is labour.
5. The supply of labour is unchanged.
6. All units of labour is homogenous.
7. Prices of two commodities are determined by labour cost i.e. the no. of labour units employed to produce each.
8. Production is the subject to the law of constant returns.
9. Technological knowledge is unchanged.
10. Trade barriers between the two countries takes place on the basis of the barter system.
11. Factors of production are perfectly mobile within each country but are perfectly immobile between countries.
12. There is free trade between the two countries, there being no trade barriers or restrictions in the movement of commodities.
13. Trade is free from cost of transportation.
14. All factors of production are fully employed in both the countries.
15. The international market is perfect so that the exchange ration for the two commodities is the same

Explanation of the Theory

Suppose the production of a unit of wine in England requires 120 men for a year, while a unit of cloth requires 100 men for the same period. On the other hand, the production of the same quantities of wine and cloth in Portugal requires 80 and 90 men respectively. Thus England uses more labour than Portugal in producing both wine and cloth. Hence Portugal possesses an absolute advantage in both wine and cloth. Amongst the two Portugal's greater advantage is production of wine and exporting to England. Since the cost of production of wine 80/120 men is less than the cost of production of cloth 90/100 men. On the other hand, it is England's interest to

specialize in the production of cloth in which it has least comparative disadvantage. Since the cost of production of cloth in England is less (100/90 men) as compared with wine (120/80 men). Thus trade is beneficial for both the countries.

Derivatives of the Theory

The advantages desired from this theory are:
1. Efficient allocation of global resources.
2. Maximization of global production at the least possible cost.
3. Product prices become more or less equal among world markets.
4. Demand for resources and products among world nations will be optimized.

There may be a second case, where two countries can produce two commodities. The factors of production may be so distributed that one country may produce both the commodities at a lower cost than the other country, but the greater advantage lies in the production of any one commodity instead of two. There is, therefore, a need for specialization. This is explained below.

Suppose:
In India, 10 days of labour can produce 100 units of cotton or
In India, 10 days of labour can produce 100 units of jute.
In Pakistan, 10 days of labour can produce 40 units of cotton or
In Pakistan, 10 days of labour can produce 80 units of jute.
In this example, the internal cost-ratio between cotton and jute in India is 100:100 or 1 unit of cotton = 1 unit of jute. Similarly, the internal cost-ratio in Pakistan, between cotton and jute is 40:80 or 1 unit of cotton = 2 units of jute.

Comparative cost difference implies that, one of the two countries has an absolute advantage in the production of one commodity, than in the production of the other. In our example, India has an absolute advantage in the production of both the goods, since it can produce both, cotton and jute at a lower cost, as compared to Pakistan. But India's advantage is comparatively greater in the production of cotton, than in jute:

$$\frac{\text{100 units of cotton in India}}{\text{40 units of cotton in Pakistan}} > \frac{\text{100 units of jute in India}}{\text{80 units of jute in Pakistan}}$$

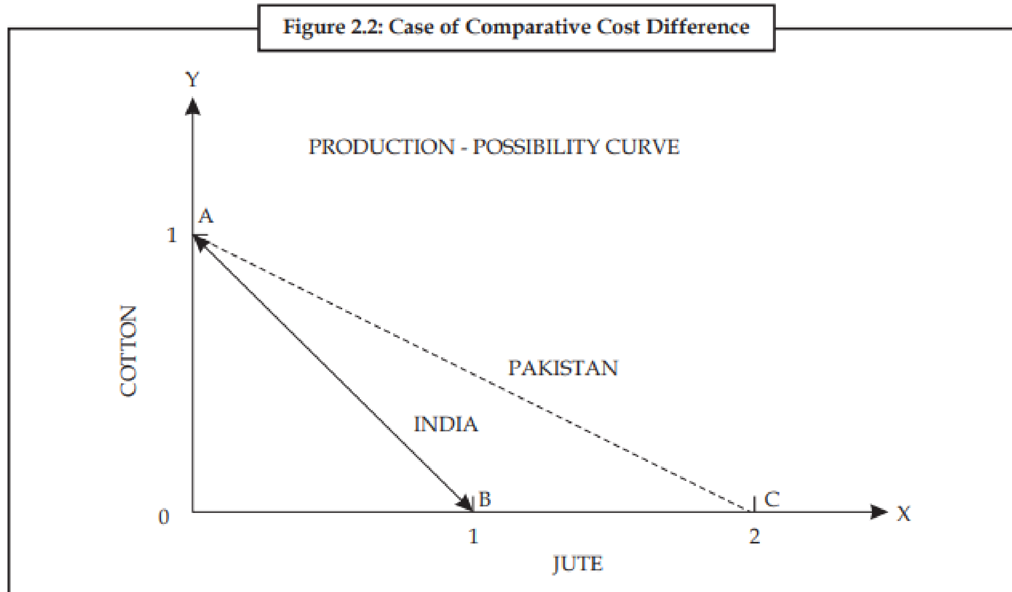
On the other hand, Pakistan has cost disadvantages in the production of both the goods, but its comparative cost disadvantage is less in the production of jute, than in cotton. To express the idea differently, Pakistan has a comparative cost advantage in the same production of jute, than in cotton:

$$\frac{\text{80 units of jute in Pakistan}}{\text{100 units of jute in India}} > \frac{\text{40 units of cotton in Pakistan}}{\text{100 units of cotton in India}}$$

International trade will be beneficial to both the countries, if each of them specializes in the production of that commodity, in which it has comparative cost advantage. India, therefore, will be prepared to specialize in cotton and export part of it, so long as it can get more than one unit of jute for 1 unit of cotton. Pakistan, on the other hand, will specialize in jute, provided it can secure 1 unit of cotton for 2 units of jute. Any rate between 1 to 2 units of jute for 1 unit of

cotton, will benefit both the countries. Under such conditions, international trade is beneficial and hence, possible between the two countries. The principle of comparative advantage is explained in Figure 2.2.

Figure 2.2: Case of Comparative Cost Difference



In the figure, the line AB, represents the production-possibility curve for India and is based on the cost-ratio of 1 unit of cotton = 1 unit of jute. Line AC, explains the production-possibility curve for Pakistan and is based on the internal cost-ratio of l unit of cotton = 2 unit of jute. BC, is a pure economic surplus, which is to be shared by the two countries through trade. Any rate of exchange between B and C will be beneficial to the two countries. Criticisms of the Theory For a very long time, the classical theory of comparative cost, as formulated by Ricardo and refined by Mill et. al., held an undisputed say. It was considered to be the most appropriate explanation of the basis of international trade. Prof. Samuelson, expressing the elegance of this theory writes that, “If theories, like girls, could win beauty contests, the comparative advantage would certainly rate high in that, it is an elegantly logical structure.” But in spite of its popularity, the theory has been put to a severe critical examination by some modern economists, like, Bertil Ohlin and Frank Graham. Ohlin describes the theory as clumsy and dangerous, i.e. unduly cumbersome and unreal. Moreover, it has been founded on an unrealistic assumption and has, therefore, been vigorously attacked as under:

1. Assumption of labour cost is no longer valid: The most forthright attack against the theory is, because of its assumption of labour costs. The assumption of labour theory of value on which it is based, has been long discarded. In actual practice all costs, nowadays, are measured in terms of money. Therefore, with the collapse of this major support, the theory falls flat. Here, it may be pointed out in support of the theory that it will be unjust to condemn it, merely on account of this assumption. Ricardo had expressed the theory in terms of labour costs because of the prevailing belief in the labour theory of value. However, even if the assumption of labour cost is discarded and cost differences are translated in terms of money, the basic contents of the theory will still be valid.

2. Labor is not the only factor: Another objection against the comparative cost theory is that it regards labour as the only factor of production. In the modern enterprise, factors like 'capital' and 'entrepreneur' assume greater importance as compared to labour. On this account also, to restrict the cost of production only to labour cost is highly unrealistic and makes the theory ineffective.

3. Assumption of constant cost not valid: The classical theory is based on the unrealistic assumption of constant costs in real life. However, after a certain stage, every production is subject to increasing costs or diminishing returns. Thus, additional quantities, beyond this stage, can be produced only at a higher cost. As a result of this, with every increase in production, the cost-ratios in the two countries may be so altered that they may finally come to represent equal differences, rather than the comparative differences. The law of increasing costs, thus, implies another limitation of the theory of comparative cost.

4. Too much emphasis on supply side: Prof. Ohlin criticizes the theory on account of its complete neglect of the demand conditions. He regards the theory as "nothing more than abbreviated account of the conditions of supply." Because of their assumption of constant costs, classical economist explained the cost difference on the basis of supply conditions only. But, as we have seen above that costs do not remain constant; they do change with changes in output, which in turn is influenced by the level of demand.

5. Static theory: The theory is static in the sense that it assumes so many things as given and unalterable. Assumptions like 'full employment' and 'fixed and constant supply of factors of production' are far from reality. In the real world, everything is changing and changeable. The theory, therefore, does not fit into the dynamic nature of the present-day world.

6. Assumption of perfect mobility of factors within a country and their perfect immobility between the countries is not valid: Ohlin regards this assumption as dangerous and misleading. If the factors are mobile within a country, then why are there differences in wages in different occupations and differences in rates of interest in different regions? He regards the classical doctrine of comparative costs as a clumsy tool of analysis. Ohlin rejects the classical assumption of the immobility of factors of production between countries, as the basis of international trade. For him, immobility of factors is not a special feature of international trade, but is also prevalent within the different regions of the same country.

7. Assumption of perfect competition is unrealistic: Like other theories of classical economists, the comparative cost theory is also based on the assumption of perfect competition but it has been amply proved by modern economists that perfect competition exists nowhere. What we actually have is some sort of imperfect competition.

8. Absence of transport costs: The theory assumes transport costs to be absent. Actually, however, transport costs do make a difference in the direction and volume of international trade. There are several branches of production in which transport costs are even higher than production costs. A particular commodity cannot enter into international trade, unless the difference in production costs between the two countries is higher than the costs of transporting it from one country to another. Transport costs are, thus, too important to be

ignored. For example, sometime back Germany was one of the leading exporters of coal and yet some of the near-by German ports found it more economical to import coal from Britain. Here, comparative advantage was outweighed by transport costs.

9. Based on two countries – two commodities model: The theory has also been criticized on the ground that it takes into consideration only two countries having only two commodities to exchange. In actual practice, trade is multilateral, involving many countries. This, however, is not a very damaging criticism. Even if this assumption is removed, it will not make a material change in the basic contents of the theory.

10. Comparative advantage and specialization: Professor Graham points out that the theory loses its ground, when we find that comparative advantages will never lead to complete specialization on the part of two countries, which enter into international trade. This may happen when one country is big and another small. The small country will be in a position to specialize fully as, "it can dispose off its surplus, to the other country. But the bigger country cannot have such complete specialization because:

(a) It will not be able to meet all its requirements fully from the foreign country; and
(b) If it will fully specialize in a particular production, its surplus output will be of such a large magnitude that it will not be entirely absorbed by the importing small country.

2.3 RELATIVE FACTOR ENDOWMENT THEORY

Two Swedish economists Eli Heckscher and Bertil Ohlin developed the factor proportion theory of international trade, also known as the modern theory of international trade. Modern Theory of International Trade was propounded by Heckscher in an article published in 1919. It was further improved upon by his student Bertil Ohlin in a research paper published in 1924 and later in his book "International and Inter-regional Trade" published in 1933. This theory does not contradict Comparative Cost Theory of International Trade, rather supports it. According to Comparative Cost Theory, international trade takes place because of difference in comparative costs. But it throws little light on the factors accounting for the difference in comparative costs. On the contrary, modern theory of international trade reveals the causes responsible for difference in the international trade.

Statement of the Theory

According to this theory, there is difference in factor endowments among different countries of the world. For instance, certain countries have comparatively large supply of labour while in others the supply of capital is relatively large. Because of difference in factor endowments there is difference in the prices of the factors. Difference in the prices of the factors depends on their relative scarcity or abundance. Owing to difference in the prices of the factors, there is difference in the costs of the goods. Hence, this theory states that the main cause of difference in comparative costs is the difference in factor endowment. Thus, international, trade takes place because of diversity in factor endowments and hence difference in prices. Each country will export that commodity in the production of which such factor is used whose supply is relatively abundant and price is relatively cheaper.

Assumptions of the Theory

Some of the assumptions of the theory are discussed below:

1. This theory relates to two countries, two commodities and two factors. It is therefore called $2 \times 2 \times 2$ model.
2. There is same production function for each commodity in two countries.
3. Factors are mobile within the country but immobile between two countries.
4. There is perfect competition in all markets. As a result (i) all factors are fully employed, (ii) factors get their reward in accordance with their marginal productivity, (iii) prices of the commodities are equal to their marginal productivity.
5. No restriction is imposed on the exchange of goods, i.e., free trade exists between two countries.
6. Consumers' tastes and preferences are identical in two countries.
7. Technique of production employed in two countries is the same.
8. There is lack of transport costs.
9. Factor endowments are different in two countries

2.4 COUNTRY SIMILARITY THEORY

This theory was developed by Staffan B. Linder, a Swedish economist, on the basis of his observation of the pattern of international trade since 1970s. According to this theory, developed countries trade more with other developed countries. About ¾ of total world exports is among the developed countries.

This fact, by itself, is an indictment of Heckscher-Ohlin's factor endowment theory. According to the H-O theorem, the incentive to trade is greatest among nations of radically different factor endowments. This means that trade would take place in larger part between developed manufacturing countries and developing countries producing primary products (i.e., natural resource commodities such as oil and petroleum) and labour-intensive products.

2.5 PRODUCT LIFE CYCLE

Theory Raymond Vernon initially proposed the product life cycle theory in the mid-1960s.Vernon argued that the wealth and size of the US market gave us firms a strong incentive to develop cost-saving process innovations. Vernon further argued that most new products were initially produced in America. Apparently, the pioneering firms believed it was better to keep production facilities close to the market and to the firm's centre of decision-making, given the uncertainty and risks inherent in introducing new products. Also the demand for most new products to be raised on non-price factors. Consequently, firms can charge relatively high prices for new products, which obviate the need to look for low-cost production sites in other countries.

Vernon went on to argue that early in the life cycle of a typical new product, while demand is starting to grow rapidly in the United States, demand in other advanced countries is limited to high-income groups. The limited initial demand in other advanced countries does not make it worthwhile for firms in those countries to start producing the new product, but it does necessitate some exports from the United States to those countries.

Overtime demand for the new product starts to grow in other advanced countries (e.g. Great Britain, France, Germany and Japan). It becomes profitable for foreign producers to begin producing for their home markets. In addition, US firms might set up production facilities in those advanced countries where demand is growing.

If cost pressures become intense, the process might not stop there. The cycle by which the United States lost its advantage to other advanced countries might be repeated once mare, as developing countries (e.g. Thailand) begin to acquire a production advantage over advanced countries. Thus the focus of global production initially switches from the United States to other advanced nations and then from those nations to developing countries.

2.6 STAGES OF PRODUCT LIFE CYCLE

There are three stages of the product cycle.

Stage 1: The New Product

Innovation requires highly skilled labour and large quantities of capital for research and development. The product will normally be most effectively designed and initially manufactured near the parent firm and therefore in a highly industrialized market due to the need for proximity, information and communication other than the many different skilled-labour components required.

In the development stage, the product is non-standardized. The production process requires a high degree of flexibility (meaning continued use of highly skilled labour). Costs of production are therefore quite high. The innovator at this stage is a monopolist and therefore enjoys all of the benefits of monopoly power, including the high profit margins required to repay the high development costs and expensive production process. Price elasticity of demand at this stage is low; high-income consumers buy it regardless of cost.

Stage 2: The Maturing Product

As production expands, its process becomes increasingly standardized. The need for flexibility in design and manufacturing decline, and therefore, the demand for highly skilled labour also decline. The innovating country increases its sales to other countries. Competitors with slight variations develop, putting downward pressure on prices and profit margins. Production costs are an increasing concern.

As competitors increase their pressures on price, the innovating firm faces critical decisions on how to maintain market share. Vernon argues that the firm faces a critical decision at this stage, either to lose market share to foreign-based manufacturers using cheaper labour or to maintain its market share by exploiting the comparative advantages of factor costs by investing in other countries. This is one of the first theoretical explanations of how trade and investment become increasingly intertwined.

Stage 3: The Standardized Product

In this final stage, the product is completely standardized in its manufacture. Thus, with access to capital in world capital markets, the country of production is simply the one with the cheapest unskilled labour. Profit margins are thin and competition is fierce. The product has largely run its course in terms of profitability for the innovating firm.

The country of comparative advantage therefore, shifts as the technology of the product's manufacture matures. The same product shifts in its production location. The country producing the product during that stage enjoys the benefits of net trade surpluses. But such advantages are fleeting, according to Vernon. As knowledge and technology continually change, so does the comparative advantage of the producer country

2.7 SUMMARY

This unit attempts to give an overview of the functions in as simple manner as possible. This unit has reviewed a number of theories that explain why it is beneficial for a country to engage in international trade and has explained the pattern of international trade that we observe in the world economy.

We have seen how the theories of Smith, Ricardo, and Heckscher-Ohlin all make strong cases for unrestricted free trade.

In contrast, the mercantilist doctrine and, to a lesser extent, the new trade theory can be interpreted to support government intervention to prevent exports through subsidies and to limit imports through tariffs and quotas.

In explaining the pattern of international trade, we have seen that with the exception of mercantilism, which is silent on this issue, the different theories offer largely complementary explanations.

Although no one theory may explain the apparent pattern of international trade, taken together, the theory of comparative advantage, the Heckscher-Ohlin theory and Porter's theory of national competitive advantage tells us that productivity differences are important.

Heckscher-Ohlin tells us that factor endowments matter; the product life cycle theory tells us that where a new product is introduced is important; the new trade theory tells us that increasing returns to specialization and first-mover advantages matter; and Porter tells us that all these factors may be important insofar as they impact the four components of national demand.

2.8 KEYWORDS

Absolute Advantage: A country has an absolute advantage in the production of a product when it is more efficient than any other country at producing it.

Comparative Advantage: The theory that countries should specialize in the production of goods

and services they can produce more efficiently. A country is said to have a comparative advantage in the production of such goods and services.

Factor Endowments: A country is endowed with resources such as land, labour and capital.

Isocost Line: It is that line which shows the various combinations of factors which can be obtained at the same cost. It is also called budget line. It shows what possible combinations of factors a firm can obtain at the same cost. Isocost line also shows cost-ratio of the factors.

Isoproduct Curve: It is a curve that shows different possible combinations of two factors of production, like capital and labour, yielding the same amount of output.

Physical Criterion of Factor Abundance or Scarcity: It means that if in a country capital ratio is greater than labour as against another country, then it will be called capital intensive country.

2.9 SELF ASSESSMENT QUESTIONS

1. Mercantilism is a bankrupt theory that has no place in the modern world." Discuss.
2. Drawing on the theory of comparative advantage to support your arguments, outline the case for free trade.
3. What are the potential costs of adopting a free trade regime? Do you think governments should do anything to reduce these costs?
4. "If theories, like girls, could win beauty contests, the comparative cost theory would certainly rate high in that, it is an elegant logical structure". Discuss.
5. Critically explain comparative advantage theory of international trade.
6. Explain the comparative cost theory of international trade. What are its assumptions and limitations?
7. What are the main drawbacks of comparative cost theory of Ricardo? How can this drawback be removed?
8. Explain the modifications in the Ricardian Comparative Advantage Theory

2.10 SUGGESTED READINGS

1) Cherunillam Francis, International Business, Text and Cases 3rd, Edition, PrenticeHall of India Private Limited
2) Charles W.L. Hill, International Business Competing in the Global Marketplace, 4th Edition, Tata McGraw Hill, Publishing Company Limited Salvatore, Dominick, International Economics, John Wiley and Sons, New York, Chapter 2 and 3.
3) Online links http://www.uwf.edu/rsjoland/WEB%20POSTED%20FILES/6%20International%20Trade%20Theory%20A%202%2004.pdf

Dr. B. NAGARAJU

LESSON-3

DESIGNING APPROPRIATE STRUCTURE OF STRATEGIC PLANNING IN MULTI NATIONAL COMPANIES (MNCS)

OBJECTIVES

- To define strategic planning
- To define strategic management
- To denote the structure of strategic planning
- To define importance of strategic planning
- To define benefits of strategic planning
- To define strategic planning process
- Strategic planning committee in a business
- Types of strategic plans
- Benefits of strategic planning

STRUCTURE

3.1. Introduction
3.2. Meaning of strategic planning
3.3. Strategic planning for multinational companies
3.4. Meaning of strategic management
    3.4.1 Strategy map
    3.4.2 Role of structure in strategic management
    3.4.3 Two types of Multi National Companies (MNCs)
    3.4.4 Two strategies commonly used by Multi National Companies (MNCs)
    3.4.5 Three Levels of Strategy
    3.4.6 Corporate planning and strategy
    3.4.7 Business planning and strategy
    3.4.8 Functional planning and strategy
3.5. Importance strategic planning
    3.5.1 The mission
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    3.5.3. Alignment with short-term goals
    3.5.4. Evaluation and revision
3.6. Benefits of Strategic Planning
    3.6.1 Helps to formulate better strategies using a logical systematic approach
    3.6.2 Enhanced communication between employers and employees
    3.6.3 Empowers individuals working in the organization
3.7 Strategic Planning Process
    3.7.1 Strategy Formulation
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    3.7.3. Strategy Evaluation
3.8. Other steps in the strategic planning process
    3.8.1 Identify
    3.8.2 Prioritize
    3.8.3 Develop

3.8.4. Implement
3.8.5.Update
3.9 Strategic planning committee in a business
3.9.1 Frequency of strategic planning in an organization
3.10 Types of strategic plans
10.1 Business
10.2 Corporate
10.3 Functional
3.11 Major Components of a Business Strategy
3.11.1 Business objective
3.11.2. Core values
3.11.3. SWOT analysis
3.11.4. Operational tactics
3.11.5 Measurement
3.12. Business Strategy Examples
3.13. Benefits of strategic planning
3.14. Summary
3.15. Key words
3.16. Self Assessment questions
3.17 Suggested Readings

3.1 INTRODUCTION

The widely accepted theory of corporate strategic planning is simple: using a time horizon of several years, top management reassesses its current strategy by looking for opportunities and threats in the environment and by analyzing the company's resources to identify its strengths and weaknesses. Management may draw up several alternative strategic scenarios and appraise them against the long-term objectives of the organization. To begin implementing the selected strategy (or continue a revalidated one), management fleshes it out in terms of the actions to be taken in the near future.

In smaller companies, strategic planning is a less formal, almost continuous process. The president and his handful of managers get together frequently to resolve strategic issues and outline their next steps. They need no elaborate, formalized planning system. Even in relatively large but undiversified corporations, the functional structure permits executives to evaluate strategic alternatives and their action implications on an ad hoc basis. The number of key executives involved in such decisions is usually small, and they are located close enough for frequent, casual get-togethers.

3.2 MEANING OF STRATEGIC PLANNING

Strategic planning is a process in which an organization's leaders define their vision for the future and identify their organization's goals and objectives. The process includes establishing the sequence in which those goals should be realized so that the organization can reach its stated vision.

Strategic planning is the art of creating specific business strategies, implementing them, and evaluating the results of executing the plan, in regard to a company's overall long-term goals or desires. It is a concept that focuses on integrating various departments (such as accounting and finance, marketing, and human resources) within a company to accomplish its strategic goals. The term strategic planning is essentially synonymous with strategic management.

The concept of strategic planning originally became popular in the 1950s and 1960s, and enjoyed favor in the corporate world up until the 1980s, when it somewhat fell out of favor. However, enthusiasm for strategic business planning was revived in the 1990s and strategic planning remains relevant in modern business.

Strategic planning typically represents mid- to long-term goals with a life span of three to five years, though it can go longer. This is different than business planning, which typically focuses on short-term, tactical goals, such as how a budget is divided up. The time covered by a business plan can range from several months to several years.

The product of strategic planning is a strategic plan. It is often reflected in a plan document or other media. These plans can be easily shared, understood and followed by various people including employees, customers, business partners and investors.

Organizations conduct strategic planning periodically to consider the effect of changing business, industry, legal and regulatory conditions. A strategic plan may be updated and revised at that time to reflect any strategic changes.

3.3 STRATEGIC PLANNING FOR MULTINATIONAL COMPANIES

Strategic planning is a process in which an organization's leaders define their vision for the future and identify their organization's goals and objectives. The process includes establishing the sequence in which those goals should be realized so that the organization can reach its stated vision.

Five steps in structure of strategic planning

Step 1: Determine present status of business
Step 2: Identify business goals and objectives
Step 3: Develop business plan
Step 4: Execute business plan
Step 5: Revise and restructure as needed

3. 4 MEANING OF STRATEGIC MANAGEMENT

Organizations that are best at aligning their actions with their strategic plans engage in strategic management. A strategic management process establishes ongoing practices to ensure that an organization's processes and resources support the strategic plan's mission and vision statement.

In simple terms, strategic management is the implementation of the strategy. As such, strategic management is sometimes referred to as strategy execution. Strategy execution involves identifying benchmarks, allocating financial and human resources and providing leadership to realize established goals.

Strategic management may involve a prescriptive or descriptive approach. A prescriptive approach focuses on how strategies should be created. It often uses an analytical approach -- such as SWOT or balanced scorecards -- to account for risks and opportunities. A descriptive approach focuses on how strategies should be implemented and typically relies on general guidelines or principles.

Given the similarities between strategic planning and strategic management, the two terms are sometimes used interchangeably.

3.4.1 Strategy map

A strategy map is a planning tool or template used to help stakeholders visualize the complete strategy of a business as one interrelated graphic. These visualizations offer a powerful way for understanding and reviewing the cause-and-effect relationships among the elements of a business strategy.

While a map can be drawn in a number of ways, all strategy maps focus on four major business areas or categories: financial, customer, internal business processes (IBPs), and learning and growth. Goals sort into those four areas, and relationships or dependencies among those goals can be established.

For example, a strategy map might include a financial goal of reducing costs and an IBP goal to improve operational efficiency. These two goals are related and can help stakeholders understand that tasks such as improving operational workflows can reduce company costs and meet two elements of the strategic plan.

A strategy map can help translate overarching goals into an action plan and goals that can be aligned and implemented.

Strategy mapping can also help to identify strategic challenges that might not be obvious. For example, one learning and growth goal may be to increase employee expertise but that may expose unexpected challenges in employee retention and compensation, which affects cost reduction goals.

3.4.2. Role of structure in strategic management

The role of structure in strategy is to facilitate delegation, authorization, review and adjustment of the strategy. The structure allows the strategy to be cascaded into the organization. It supports both the significant changes and the operational workings of the organization

The organizational structure of your business is the ground on which you build a plan. It tells you which tactics are feasible and how you should go about implementing them. Ultimately, your strategy and structure should work seamlessly together.

3.4.3. Two types of Multi National Companies (MNCs)

Multinational corporations can be categorized into four different types: decentralized multinational corporations, centralized global corporations, international companies, and transnational enterprises.

3.4.4. Two strategies commonly used by Multi National Companies (MNCs)

In-sourcing and purchasing foreign competitions are two strategies commonly used by multinational companies of all types.

3.4.5. Three Levels of Strategy

Every corporate executive uses the words *strategy* and *planning* when he talks about the most important parts of his job. The president, obviously, is concerned about strategy; strategic planning is the essence of his job. A division general manager typically thinks of himself as the president of his own enterprise, responsible for its strategy and for the strategic planning needed to keep it vibrant and growing. Even an executive in charge of a functional activity, such as a division marketing manager, recognizes that his strategic planning is crucial; after all, the company’s marketing strategy (or manufacturing strategy, or research strategy) is a key to its success.

These quite appropriate uses of strategy and planning have caused considerable confusion about long-range planning. This article attempts to dispel that confusion by differentiating among three types of “strategy” and delineating the interrelated steps involved in doing three types of “strategic planning” in large, diversified corporations. (Admittedly, although we think our definitions of strategy and planning are useful, others give different but reasonable meanings to these words.)

The process of strategy formulation can be thought of as taking place at the three organizational levels indicated in Exhibit I: headquarters (corporate strategy), division (business strategy), and department (functional strategy). The planning processes leading to the formulation of these strategies can be labeled in parallel fashion as corporate planning, business planning, and functional planning. We have to define these notations briefly before constructing the framework of the planning process:

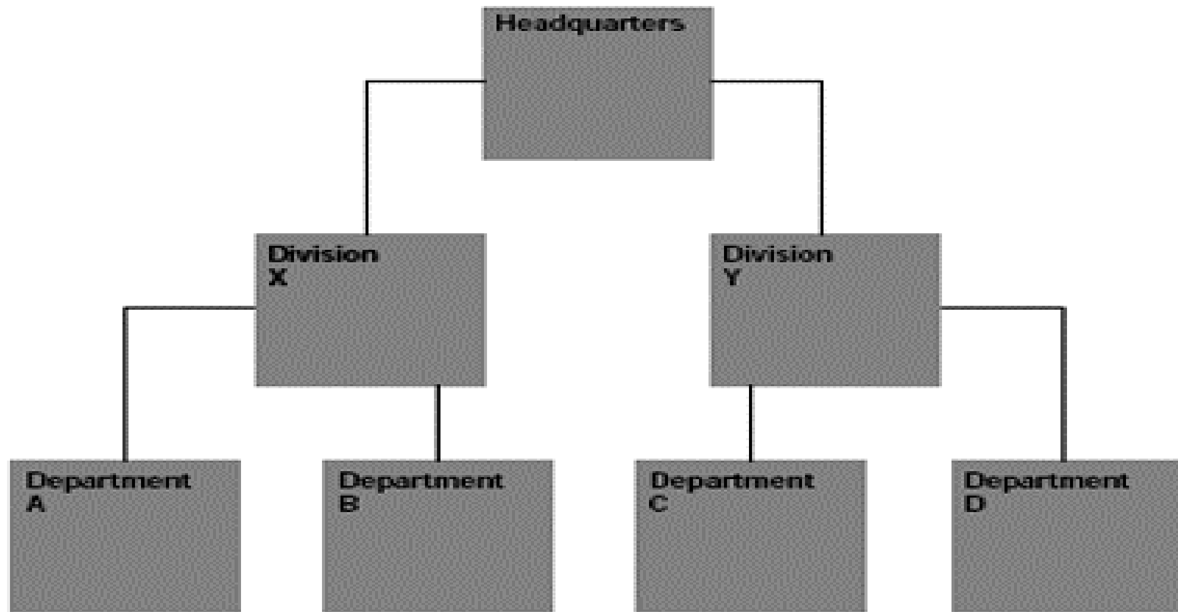

Figure 1: Structure of divisional corporation

3.4.5.1. Corporate planning and strategy: Corporate objectives are established at the top levels. Corporate planning, leading to the formulation of corporate strategy, is the process of (a) deciding on the company's objectives and goals, including the determination of which and how many lines of business to engage in, (b) acquiring the resources needed to attain those objectives, and (c) allocating resources among the different businesses so that the objectives are achieved.

3.4.5.2. Business planning and strategy: Business planning, leading to the formulation of business strategy, is the process of determining the scope of a division's activities that will satisfy a broad consumer need, of deciding on the division's objectives in its defined area of operations, and of establishing the policies adopted to attain those objectives. Strategy formulation involves selecting division objectives and goals and establishing the charter of the business, after delineating the scope of its operations vis-à-vis markets, geographical areas, and/or technology.

Thus, while the scope of business planning covers a quite homogeneous set of activities, corporate planning focuses on the portfolio of the divisions' businesses. Corporate planning addresses matters relevant to the range of activities and evaluates proposed changes in one business in terms of its effects on the composition of the entire portfolio.

3.4.5.3. Functional planning and strategy: In functional planning, the departments develop a set of feasible action programs to implement division strategy, while the division selects—in the light of its objectives—the subset of programs to be executed and coordinates the action programs of the functional departments. Strategy formulation involves selecting objectives and goals for each functional area (marketing, production, finance, research, and so on) and determining the nature and sequence of actions to be taken by each area to achieve its objectives and goals. Programs are the building blocks of the strategic functional plans.

Obviously, these levels of strategy impinge on each other to some extent—for example, the corporation's choice of business areas overlaps the scope of division charters, and the delineation of the markets by the division can dictate, at the department level, the choice of strategy in the marketing function. But the distinction remains valid and useful.

3.5 IMPORTANCE STRATEGIC PLANNING

Businesses need direction and organizational goals to work toward. Strategic planning offers that type of guidance. Essentially, a strategic plan is a roadmap to get to business goals. Without such guidance, there is no way to tell whether a business is on track to reach its goals.

The following four aspects of strategy development are worth attention:

3.5.1 The mission: Strategic planning starts with a mission that offers a company a sense of purpose and direction. The organization's mission statement describes who it is, what it does and where it wants to go. Missions are typically broad but actionable. For example, a business in the education industry might seek to be a leader in online virtual educational tools and services.

3.5.2 The goals: Strategic planning involves selecting goals. Most planning uses SMART goals -- specific, measurable, achievable, realistic and time-bound -- or other objectively measurable goals. Measurable goals are important because they enable business leaders to determine how well the business is performing against goals and the overall mission. Goal setting for the fictitious educational business might include releasing the first version of a virtual classroom platform within two years or increasing sales of an existing tool by 30% in the next year.

3.5.3 Alignment with short-term goals: Strategic planning relates directly to short-term, tactical business planning and can help business leaders with everyday decision-making that better aligns with business strategy. For the fictitious educational business, leaders might choose to make strategic investments in communication and collaboration technologies, such as virtual classroom software and services but decline opportunities to establish physical classroom facilities.

3.5.4 Evaluation and revision: Strategic planning helps business leaders periodically evaluate progress against the plan and make changes or adjustments in response to changing conditions. For example, a business may seek a global presence, but legal and regulatory restrictions could emerge that affect its ability to operate in certain geographic regions. As result, business leaders might have to revise the strategic plan to redefine objectives or change progress metrics.

3.6. BENEFITS OF STRATEGIC PLANNING

The volatility of the business environment causes many firms to adopt reactive strategies rather than proactive ones. However, reactive strategies are typically only viable for the short-term, even though they may require spending a significant amount of resources and time to execute. Strategic planning helps firms prepare proactively and address issues with a more long-term view. They enable a company to initiate influence instead of just responding to situations.

Among the primary benefits derived from strategic planning are the following:

3.6.1 Helps to formulate better strategies using a logical systematic approach

This is often the most important benefit. Some studies show that the strategic planning process itself makes a significant contribution to improving a company's overall performance, regardless of the success of a specific strategy.

3.6.2 Enhanced communication between employers and employees

Communication is crucial to the success of the strategic planning process. It is initiated through participation and dialogue among the managers and employees, which shows their commitment to achieving organizational goals.

Strategic planning also helps managers and employees show commitment to the organization's goals. This is because they know what the company is doing and the reasons behind it. Strategic planning makes organizational goals and objectives real, and employees can more readily understand the relationship between their performance, the company's success, and compensation. As a result, both employees and managers tend to become more innovative and creative, which fosters further growth of the company.

3.6.3 Empowers individuals working in the organization

The increased dialogue and communication across all stages of the process strengthens employees' sense of effectiveness and importance in the company's overall success. For this reason, it is important for companies to decentralize the strategic planning process by involving lower-level managers and employees throughout the organization. A good example is that of the Walt Disney Co., which dissolved its separate strategic planning department, in favor of assigning the planning roles to individual Disney business divisions.

3.7. STRATEGIC PLANNING PROCESS

The strategic planning process requires considerable thought and planning on the part of a company's upper-level management. Before settling on a plan of action and then determining how to strategically implement it, executives may consider many possible options. In the end, a company's management will, hopefully, settle on a strategy that is most likely to produce positive results (usually defined as improving the company's bottom line) and that can be executed in a cost-efficient manner with a high likelihood of success, while avoiding undue financial risk.

The development and execution of strategic planning are typically viewed as consisting of being performed in three critical steps:

3.7.1 Strategy Formulation

In the process of formulating a strategy, a company will first assess its current situation by performing an internal and external audit. The purpose of this is to help identify the organization's strengths and weaknesses, as well as opportunities and threats (SWOT Analysis). As a result of the analysis, managers decide on which plans or markets they should focus on or

abandon, how to best allocate the company's resources, and whether to take actions such as expanding operations through a joint venture or merger.

Business strategies have long-term effects on organizational success. Only upper management executives are usually authorized to assign the resources necessary for their implementation.

3.7.2 Strategy Implementation

After a strategy is formulated, the company needs to establish specific targets or goals related to putting the strategy into action, and allocate resources for the strategy's execution. The success of the implementation stage is often determined by how good a job upper management does in regard to clearly communicating the chosen strategy throughout the company and getting all of its employees to "buy into" the desire to put the strategy into action.

Effective strategy implementation involves developing a solid structure, or framework, for implementing the strategy, maximizing the utilization of relevant resources, and redirecting marketing efforts in line with the strategy's goals and objectives.

3.7.3 Strategy Evaluation

Any savvy business person knows that success today does not guarantee success tomorrow. As such, it is important for managers to evaluate the performance of a chosen strategy after the implementation phase.

Strategy evaluation involves three crucial activities: reviewing the internal and external factors affecting the implementation of the strategy, measuring performance, and taking corrective steps to make the strategy more effective. For example, after implementing a strategy to improve customer service, a company may discover that it needs to adopt a new customer relationship management (CRM) software program in order to attain the desired improvements in customer relations.

All three steps in strategic planning occur within three hierarchical levels: upper management, middle management, and operational levels. Thus, it is imperative to foster communication and interaction among employees and managers at all levels, so as to help the firm to operate as a more functional and effective team.

3.8. OTHER STEPS IN THE STRATEGIC PLANNING PROCESS

There are myriad different ways to approach strategic planning depending on the type of business and the granularity required. Most strategic planning cycles can be summarized in these five steps:

3.8.1 Identify: A strategic planning cycle starts with the determination of a business's current strategic position. This is where stakeholders use the existing strategic plan -- including the mission statement and long-term strategic goals -- to perform assessments of the business and its environment. These assessments can include a needs assessment or a SWOT (strengths,

weaknesses, opportunities and threats) analysis to understand the state of the business and the path ahead.

3.8.2 Prioritize: Next, strategic planners set objectives and initiatives that line up with the company mission and goals and will move the business toward achieving its goals. There may be many potential goals, so planning prioritizes the most important, relevant and urgent ones. Goals may include a consideration of resource requirements -- such as budgets and equipment -- and they often involve a timeline and business metrics or KPIs for measuring progress.

3.8.3 Develop: This is the main thrust of strategic planning in which stakeholders collaborate to formulate the steps or tactics necessary to attain a stated strategic objective. This may involve creating numerous short-term tactical business plans that fit into the overarching strategy. Stakeholders involved in plan development use various tools such as a strategy map to help visualize and tweak the plan. Developing the plan may involve cost and opportunity tradeoffs that reflect business priorities. Developers may reject some initiatives if they don't support the long-term strategy.

3.8.4 Implement: Once the strategic plan is developed, it's time to put it in motion. This requires clear communication across the organization to set responsibilities, make investments, adjust policies and processes, and establish measurement and reporting. Implementation typically includes strategic management with regular strategic reviews to ensure that plans stay on track.

3.8.5 Update: A strategic plan is periodically reviewed and revised to adjust priorities and reevaluate goals as business conditions change and new opportunities emerge. Quick reviews of metrics can happen quarterly, and adjustments to the strategic plan can occur annually. Stakeholders may use balanced scorecards and other tools to assess performance against goals.

3.9. STRATEGIC PLANNING COMMITTEE IN A BUSINESS

A committee typically leads the strategic planning process. Planning experts recommend the committee include representatives from all areas within the enterprise and work in an open and transparent way where information is documented from start to finish.

The committee researches and gathers the information needed to understand the organization's current status and factors that will affect it in the future. The committee should solicit input and feedback to validate or challenge its assessment of the information.

The committee can opt to use one of many methodologies or strategic frameworks that have been developed to guide leaders through this process. These methodologies take the committee through a series of steps that include an analysis or assessment, strategy formulation, and the articulation and communication of the actions needed to move the organization toward its strategic vision.

The committee creates benchmarks that will enable the organization to determine how well it is performing against its goals as it implements the strategic plan. The planning process

should also identify which executives are accountable for ensuring that benchmarking activities take place at planned times and that specific objectives are met.

3.9.1 Frequency of strategic planning in an organization

There are no uniform requirements to dictate the frequency of a strategic planning cycle. However, there are common approaches.

a) **Quarterly reviews**. Once a quarter is usually a convenient time frame to revisit assumptions made in the planning process and gauge progress by checking metrics against the plan.

b) **Annual reviews.** A yearly review lets business leaders assess metrics for the previous four quarters and make informed adjustments to the plan.

Timetables are always subject to change. Timing should be flexible and tailored to the needs of a company. For example, a startup in a dynamic industry might revisit its strategic plan monthly. A mature business in a well-established industry might opt to revisit the plan less frequently.

3.10 TYPES OF STRATEGIC PLANS

Strategic planning activities typically focus on three areas: business, corporate or functional. They break out as follows:

3.10.1 Business: A business-centric strategic plan focuses on the competitive aspects of the organization creating competitive advantages and opportunities for growth. These plans adopt a mission evaluating the external business environment, setting goals, and allocating financial, human and technological resources to meet those goals. This is the typical strategic plan and the main focus of this article.

3.10.2 Corporate: A corporate-centric plan defines how the company works. It focuses on organizing and aligning the structure of the business, its policies and processes and its senior leadership to meet desired goals. For example, the management of a research and development skunk works might be structured to function dynamically and on an ad hoc basis. It would look different from the management team in finance or HR.

3.10.3 Functional: Function-centric strategic plans fit within corporate-level strategies and provide a granular examination of specific departments or segments such as marketing, HR, finance and development. Functional plans focus on policy and process -- such as security and compliance -- while setting budgets and resource allocations.

In most cases, a strategic plan will involve elements of all three focus areas. But the plan may lean toward one focus area depending on the needs and type of business

3.11. MAJOR COMPONENTS OF A BUSINESS STRATEGY

There are five key components to help you build an effective business strategy. They include:

3.11.1 Business objective: Business objective or mission statement identifies a gap in the market that your business hopes to address. Any business strategy you set out to implement is required to always link back to this vision. Think of a business strategy as an action plan with detailed instructions on how those responsible require achieving the organizational goal.

3.11.2 Core values: According to the organization's core values, your business strategy is required to communicate clear guidelines on what people are required to do and need not do. Articulating these values on paper encourages coworkers to hold themselves accountable to the organization's standards.

3.11.3 SWOT analysis: SWOT stands for strengths, weaknesses, opportunities and threats. This analysis is integral to your business strategy, as it represents a snapshot of the company's current situation. Identifying these four key areas prepares you for challenges you may encounter along the way. It shows what strengths you can use to your advantage and exposes weaknesses you require to address.

3.11.4 Operational tactics: A business strategy needs to transform a vision and plan into action. Once you identify business resources through a SWOT analysis, business can then allocate them accordingly. Operational tactics prioritize what needs to get done now and what can wait for later. It helps to manage business time and resources efficiently.

3.11.5 Measurement: To evaluate a business strategy's effectiveness, you require incorporating a means of tracking business performance. It works best when a business divides its objective into smaller targets that you can measure regularly. For example, a business can measure its output through smaller financial milestones.

Focus on business strategy

It is always beneficial to implement a business strategy because it brings more intentional thought to your operations. When businesses make sizable shifts, business strategies become even more important because they lay the groundwork on how to maximize returns. But, a strategy is not just about growth; it also ensures business take full advantage of an available opportunity in the market.

Here are a few situations when any business may require focusing on business strategy:

a) Starting a new business
b) Plans to sell an existing enterprise
c) Raising funds among family, friends, the public or investors
d) Seeking a new business partner
e) Rebranding an existing business
f) Investing money into improving a business
g) Expanding an organization into a new market or region
h) Merging with another organization
i) Major internal changes such as personnel changes

3.12 BUSINESS STRATEGY EXAMPLES

A business strategy can highlight strengths for you to employ as a unique selling point for your product and service. Here are six examples of great business strategies:

3.12.1 Product differentiation

Many companies, particularly in the technology or automotive space, differentiate themselves through their innovation. To get yourself noticed using this business strategy, you require to highlight that your products are superior because of their technology, pricing, features or even design. Product differentiation is an effective strategy because it sets you apart from competitors. In return, customers are loyal to you because of the uniqueness only you can offer them.

3.12.2 Improve customer experience

Businesses build their reputation on exemplary customer service. Usually, companies may struggle in a particular area in their customer experience, so a business strategy focused on improving service would usually concentrate its objectives on something like online support or a more effective call center.

3.12.3 Cornering a younger market

Organizations see great value in tapping into customers at a young age so that they continue associating with a brand as they get older. Some larger companies buy out their competitors to gain a share of this lucrative market. Cornering a young market allows you to increase your presence in a new demographic while retaining your existing customer base.

3.12.4. Attractive pricing strategy

The way you price your products and services can impact the way customers perceive your business. An affordable pricing strategy is a great option to attract new customers. Pricing your products beyond what ordinary customers can afford gives an aspiration value to your brand.

Both pricing strategies are powerful, but they require a different business approach. Businesses that keep their prices low require achieving higher volumes to be profitable. In comparison, companies who choose higher prices can maintain the exclusivity of their product while retaining a large profit margin per product.

3.12.5 Sustainability

As people become more environmentally conscious, the demand for sustainable products has increased as well. A business strategy that positions an organization as a socially responsible business also demonstrates other desirable values, such as trust and integrity. Some

examples of sustainable business practices include goals to reduce energy costs or to decrease the company's carbon footprint by implementing a recycling program.

3.12.6 Cross-sell more products

Some organizations focus on selling more products to the same customer. This strategy is popular among banks, insurance firms and online retailers. By increasing the number of products sold per customer, you can decrease your customer acquisition cost and spend less on marketing.

3.13. BENEFITS OF STRATEGIC PLANNING

Effective strategic planning has many benefits. It forces organizations to be aware of the future state of opportunities and challenges. It also forces them to anticipate risks and understand what resources will be needed to seize opportunities and overcome strategic issues.

Strategic planning also gives individuals a sense of direction and marshals them around a common mission. It creates standards and accountability. Strategic planning can enhance operational plans and efficiency. It also helps organizations limit time spent on crisis management, where they're reacting to unexpected changes that they failed to anticipate and prepare for.

3.14 SUMMARY

Strategic planning is a process in which an organization's leaders define their vision for the future and identify their organization's goals and objectives. The process includes establishing the sequence in which those goals should be realized so that the organization can reach its stated vision. Strategic analysis (sometimes referred to as a strategic market analysis) is the process of gathering data that helps a company's leaders decide on priorities and goals, shaping (or shifting) a long-term strategy for the business.

3.15. KEY WORDS

- **Strategic management:** Strategic management involves setting objectives, analyzing the competitive environment, analyzing the internal organization, evaluating strategies, and ensuring that management rolls out the strategies across the organization.

- **Structure planning**: It is a tool for managing the effects and demands of development or redevelopment of larger areas held in multiple ownership in an integrated, holistic and orderly way.

- **Strategy map**: It is a simple graphic that shows a logical, cause-and-effect connection between strategic objectives (shown as ovals on the map). It is one of the most powerful elements in the balanced scorecard methodology, as it is used to quickly communicate how value is created by the organization.

- **Multinational Corporation (MNC):** It is one that has business offices and operations in two or more countries in the world. These companies are often managed from a central office headquartered in the home country.

- **Strategic planning:** It is a process in which an organization's leaders define their vision for the future and identify their organization's goals and objectives. The process includes establishing the sequence in which those goals should be realized so that the organization can reach its stated vision.

- **SWOT Analysis:** SWOT stands for Strengths, Weaknesses, Opportunities, and Threats, and so a SWOT analysis is a technique for assessing these four aspects of your business. SWOT Analysis is a tool that can help you to analyze what your company does best now, and to devise a successful strategy for the future.

- **Business strategy**: It is the strategic initiatives a company pursues to create value for the organization and its stakeholders and gain a competitive advantage in the market. This strategy is crucial to a company's success and is needed before any goods or services are produced or delivered.

3.16 SELF ASSESSMENT QUESTIONS

1. What is strategic planning and explain strategic planning for Multinational Companies (MNCs)?
2. What is strategic management and what is strategy map?
3. Explain the role of structure in strategic management and three levels of strategy?
4. Explain the importance strategic planning and benefits of strategic planning?
5. Explain Strategic Planning Process and other steps in strategic planning process?
6. Explain strategic planning committee in a business?

3.17 SUGGESTED READINGS

1. Strategic Management and Business Policy: Globalization, Innovation and Sustainability | Fifteenth Edition | By Pearson Paperback – 30 July 2018, ISBN-10 : 9789352861897.
2. Strategic Management, 5th edition paperback By Azhar Kazmi and Adela Kazmi, McGraw Hill; Fifth edition (10 December 2020); McGraw Hill Education (India) Private Limited, Noida, UP, ISBN-10 : 8194740045
3. International Journal of Business and Strategic Management Vol 6 No 4 (2021), Category Book Chapters, CARI journals and books publishers, Paul Waithaka, Edwin Mawira Kubai, Janepher Dzine Mwamuye, Poi Godwin, ISBN:978-9914-746-75-4
4. Advanced Strategic Planning, Aubrey Malphurs, Baker Publishing, New Delhi, 2013, ISBN 139-78080-101-4550.

Dr. K. SUDHEER KUMAR

LESSON -4

STRATEGIC CONSIDERATIONS

OBJECTIVES:

- To define the concept of international business strategy
- To explain the need for global expansion of business
- To define strategic considerations of international business
- To explain four types of international strategies
- To define the benefits of global business expansion
- To define the methods of global expansion
- To define the global expansion risks

STRUCTURE

4.1 Introduction
4.2 Meaning of international strategy
4.3 Need for global expansion
4.4 Strategic considerations of international business
4.5 Four types of international strategies
    4.5.1 International strategy
    4.5.2 Multi-domestic strategy
    4.5.3 Global strategy
    4.5.4 Transnational strategy
    4.5.5 Other strategic considerations for international business expansion
4.6 The benefits of global business expansion
    4.6.1 Global expansion elevates business growth
    4.6.2 Global expansion creates new revenue streams
    4.6.3 Global expansion boosts global brand recognition
    4.6.4 Global expansion gives access to an international talent pool
4.7 Methods of Global expansion
    4.7.1 Market research
    4.7.2 Use the PESTEL framework
    4.7.3 Learn from the competition
    4.7.4 Rely on local experts across fields
    4.7.5 Adapt product for international markets
    4.7.6 Localization is integral to global expansion strategies
    4.7.7 Make a splash in international business
4.8 Ignorance or lack of understanding of cultural differences
    4.8.1 Incomplete insight into political, legal, and compliance environments
    4.8.2 Potentially higher initial investment and waiting for long-term gains
    4.8.3 Insufficient attention to marketing and advertising requirements
4.9 Summary
4.10 Key words
4.11 Self Assessment questions
4.12 Suggested Readings

4.1 INTRODUCTION

Many companies invest and build capacity for creating economies of scale. Companies target expansion into new markets by efficiently using their potential and creating additional sustainable income opportunities. In light of this, there are various opportunities both in developed countries, where there is larger demand, and in developing countries where there is increasing demand. Companies need to target and plan their international growth strategy for success.

4.2 MEANING OF INTERNATIONAL STRATEGY

An international strategy is usually the first approach most businesses take with global expansion. Exporting or importing goods and services while maintaining a head office or offices in their home country. Global expansion as a business doesn't have a one-size-fits-all approach.

4.3 NEED FOR GLOBAL EXPANSION

Global expansion opens new opportunities for organizations, improving profitability, creating new revenue, and enhancing the company's reputation. There are many benefits to expanding your business globally and international organizations can test the limits of what is possible for their brands and their target customers.

Just as founders build businesses for many different reasons, business leaders expand globally with many unique motives and goals in mind.

4.4 STRATEGIC CONSIDERATIONS OF INTERNATIONAL BUSINESS

International business dealings require one consideration than when only handling matters with one country. This means that the culture, legal and regulatory barriers, foreign government and other business case matters must be understood and factored in when achieving company and interactions through business deals.

4.5 FOUR TYPES OF INTERNATIONAL STRATEGIES

In fact, there are four different common strategies businesses use to expand internationally. They are:

i. International strategy.
ii. Multi-focal (Multi-domestic strategy).
iii. Global strategy.
iv. Transnational strategy

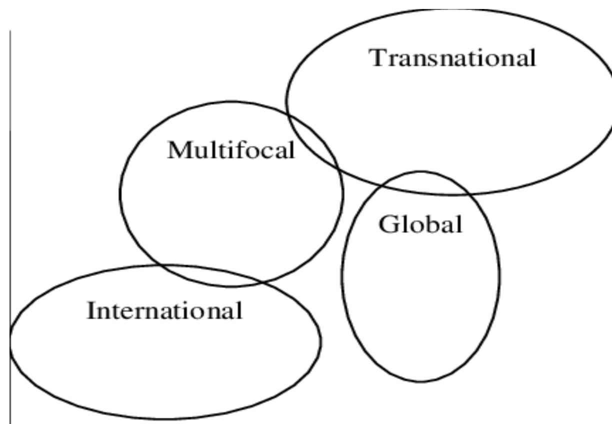

Figure 1: Four types of international strategies

4.5.1. International strategy

Applying an international strategy involves entering a new market without significantly changing product features or pricing strategy. Products or services are sold at similar price points and with the same branding, functionality, and design.

To casual observers, product would probably be identical regardless of which country or region they buy it in. It wouldn't be cheaper than it was before, even if local competitors offer a similar product at a different price. An International strategy doesn't involve lowering the price to compete with local alternatives.

For example, a Rolex timepiece is made in Switzerland and appeals to buyers based on the brand's reputation for quality. Wherever we are in the world, if we look for a Rolex watch, we will probably find similar pricing and the same designs and options available. We can generally expect Rolex watches that are designed for the Swiss market to look the same and have the same quality that Rolex watches sold in the United States (US), Italy, France, the UK, or anywhere else have.

4.5.2 Multi-focal (Multi-domestic strategy)

By using a multi-domestic strategy, other companies take a different approach that adapts to local cultures and markets. Each country's unique local tastes and preferences are accounted for with products or services that are customized to be more competitive within that particular market. Similar to an international strategy, a multi-domestic strategy doesn't compete primarily on pricing.

For some companies, this approach of unique modifications for each market could be expensive, but a multi-domestic strategy doesn't focus on reducing prices to gain market share. Your products will still have the same pricing in a different market.

Lay's, a potato chip brand based in the US and a wholly owned subsidiary of PepsiCo, has other brand names operating in other countries. UK customers buy Walkers' crisps in flavors such as paprika that would be uncommon or unavailable in Lay's domestic market.

4.5.3 Global strategy

In direct contrast to multi-domestic, a global strategy involves building cost-effective operations for international markets, which minimize local and regional variation. Products or services are largely the same in every market to reduce costs as much as possible and become an industry leader. Companies following this approach want to undercut competitor pricing in every market they operate in.

For products where the price is important but customization isn't, a global strategy is a particularly good fit. Components supplied for manufacturing consumer products are one example.

Perhaps one of the best-known companies using a global strategy is Coca-Cola. This popular brand's soft drinks are fairly uniform around the world—a "Coke" may be packaged, distributed, or promoted differently in different markets, but it'll probably taste the same whether you buy it in the US or Germany.

4.5.4 Transnational strategy

For companies that want to build both customization and reduced costs into their global expansion strategy, a transnational strategy may be the best choice. Transnational strategy looks for ways to optimize product fit within each market while also managing costs and process efficiencies. Most of the products are very similar, making it possible to use the same suppliers and avoid having to create separate supply chains, reducing the costs associated with selling to multiple markets. Some minor customization is easily added on without creating too much change or extra costs.

Ice Cream Company Baskin Robbins sells different flavors of ice cream in different countries, often taking inspiration from local cuisines. In Asia, you might find match a chocolate ice cream but not at all Baskin Robbins stores around the world.

4.5.5 Other strategic considerations for international business expansion:

There are 9 other considerations for successfully going global. They are
Language, infrastructure, payments, legal requirements, cultural norms, operations. Decide how to structure business overseas, hiring, determine how to go about the hiring process, payroll and compliance.

4.6 THE BENEFITS OF GLOBAL BUSINESS EXPANSION

Global business expansion offers many tangible benefits for organizations. Interest in global growth is strong because companies know that international expansion is a great way to grow a business, create new revenue streams, build brand recognition, and hire global talent.

4.6.1 Global expansion elevates business growth

Expanding a business internationally provides companies with access to additional markets. Entering new markets helps businesses grow beyond the customers and prospective buyers in their original country. A worldwide market means more potential buyers, markets with different needs and preferences, and markets operating within different regulatory requirements.

4.6.2 Global expansion creates new revenue streams

Entering new markets internationally gives organizations additional income, helping them become more resistant to market shocks and changes in domestic market conditions. Growing revenue by expanding internationally could be as straightforward as making products available online within additional countries, or as complex as building new factories and fulfillment centers overseas.

4.6.3 Global expansion boosts global brand recognition

By reaching other markets, your organization builds brand awareness and brand recognition with potential customers. Global expansion makes it possible for your company to become better known and establish a recognizable reputation. This creates new possibilities for product promotion and strengthens your brand.

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4.6.4 Global expansion gives access to an international talent pool

As your company grows across borders, hiring great talent from other countries generally becomes easier to accomplish. Better name recognition for your brand and familiarity with other markets can be very helpful when you're recruiting and access to an international talent pool provides your company with the opportunity to hire the best people.

4.7 METHODS OF GLOBAL EXPANSION

Following these steps to entering international markets can help your organization prepare for an effective global expansion.

4.7.1 Market research

For just about everything about international business, market research is a friend to use research to help business plan for resources and mitigate risks.

During research explore these areas further:

a) **Market audience:** Who is the target customer? Consider creating a person by choosing a real-life or fictional person (or company) who represents an ideal customer. Who are they, and what do they want? This will help understand customer needs in each of your target markets.

b) **Market demand:** Is there a demand for our product or service? How big is that demand? The more you can quantify our estimate the better.

c) **Trends:** How is the type of product or service perceived by customers? What are customers looking for and how do they usually choose the right brand or the right product? How much change or stability does the market have?

d) **Market entry strategy:** How to enter the market and what factors influence your market entry strategy? Present business may want to consider logistical details, business goals, lists of action items business need to complete, and what timeline should expect to follow.

4.7.2 Use the PESTEL framework

Another helpful research tool is PESTEL, which represents political, economic, social, technological, environmental, and legal influences. Each aspect of PESTEL can have an impact on your business, so it may be helpful to research and plan for PESTEL factors in each target country you plan to operate in.

a) **Political:** The country's government, leadership, political stability, and political climate
b) **Economic:** The general economic outlook in the target country as well as your industry's economic health
c) **Social:** Cultural values, social beliefs, religious and philosophical points of view, etc. This can include cultural history and memory
d) **Technological:** Benefits and limitations of technology available in a particular market as well as regulations surrounding its use this includes not only the technology your company uses but also technology available to your customers
e) **Environmental:** Local environmental issues, regulation, and history
f) **Legal:** The regulatory standards and processes your company will need to comply with.

Figure 2: PESTEL Framework

To conduct a PESTEL analysis of a target market, it's important to research and document as many political, economic, social, technological, environmental, and legal conditions as possible like:

a) How are the PESTEL factors different from the original market?
b) Using PESTEL, what risks are present? How do these impact present business brand?
c) Are there advantages or benefits that a brand has over competitors in these areas?
d) What should a business be watching for? Is there developing news or are there current events that could change the present market entry strategy?
e) When in doubt, it's recommendable to over-research rather than make a guess or act without good information. Research helps to protect the business from risk and reach business goals more effectively.

4.7.3 Learn from the competition

If competitors who are already reaching another market, taking a close look at their work could help business define their own market positioning in a manner that stands out from them.

Here are a few things to consider:

a) Who are the competitors in that target market?
b) Whether competitors are local or foreign companies?
c) What to analyze whether competitors are doing well?
d) Similarly, whether the competitors are doing poorly?
e) What's your business better at?
f) Is your investment likely to generate a return, even with these competitors in the same industry?

Whenever possible, learn from the competitors' discoveries and mistakes—it's less expensive to learn from someone else's decisions. Competitors are a great source of information about the market.

4.7.4 Rely on local experts across fields

Local expertise is valuable for organizations undertaking global expansion. If we can, hire local personnel or find experts who are familiar with your target market. Aside from their subject matter expertise, these experts can also help business understand important cultural differences and localization considerations may have otherwise overlooked.
Analyze before working with a local expert:

a) What fields should to hire local experts in?
b) What is their experience with the target market or culture?
c) Could this expert help business build to global reputation and local trust?

4.7.5 Adapt product for international markets

To get a foothold in the constantly evolving and highly competitive global marketplace, taking into account differences between markets is key. Potential customers in each target market need to be able to understand your product or service from the start and relate to it on an emotional level before making a buying decision.

4.7.6 Localization is integral to global expansion strategies

Making your product accessible to people across markets means adapting it to cultural differences, linguistic particularities, local expectations, purchasing power and habits, and legal requirements just to name a few aspects of a process as complex as localization. Integral to global expansion, localization requires a clear strategy and robust technology.

4.7.7 Make a splash in international business

With significant benefits to global expansion, it's little wonder that so many companies choose international growth strategies. Expanding globally is a bold step that can provide additional revenue for your company and help you grow your reputation. Using one of the 4 global expansion strategies provides a business with a solid blueprint for a successful transition.

4.8 GLOBAL EXPANSION RISKS

With many business decisions, there is risk involved. Global expansion can be risky as well, and it's worthwhile to prepare risk reduction and mitigation strategies before a business gets started.

4.8.1 Ignorance or lack of understanding of cultural differences

Cultural differences can be very significant and their impact on business shouldn't be ignored or underestimated. Social, linguistic, religious, and other misunderstandings could harm otherwise strong business plans. Decisions that show ignorance of culture can backfire and pose a serious threat to any company expanding overseas. Well-prepared business leaders carefully consider cultural differences throughout the global expansion process.

4.8.2 Incomplete insight into political, legal, and compliance environments

The wrong move on a compliance issue can be fairly costly for your business. Imagine being unaware of a tax you're required to pay, regulations in place before a business can advertise a product in another country, or other compliance conditions with significant risks.

4.8.3 Potentially higher initial investment and waiting for long-term gains

Before expanding business globally, it makes sense to count the costs and have a realistic assessment of when a business break even or generate a profit on the investment. International businesses may incur higher costs and unexpected expenses that eat away at profit margins. That's why upfront research, profit projections, and estimates are always helpful.

4.8.4 Insufficient attention to marketing and advertising requirements

Marketing and advertising can work quite differently from one culture to another. Even if you're using the same platforms or channels for reaching potential customers, you may have to follow another process to get started in another country, and this could be much different from

what you anticipated. Closely related, what is important to your market today may not fit with what other markets value.

For example, different countries often use different social media channels: While Facebook tops the US market, VK (Vkontakte) is the preferred social media platform in Russia. Similarly, planning around the popularity of Google Search isn't as helpful for businesses planning to launch a website in China, where Baidu is a more popular search engine. This makes it obvious that a business should adapt a product to the habits of a target audience if present business wants to be seen.

4.9 SUMMARY

International business strategy refers to plans that guide commercial transactions taking place between entities in different countries. Typically, it refers to the plans of actions or policies designed to achieve an overall goal of private companies rather than governments; as such, one goal may be increased profits. International business dealings require ore consideration than when only handling matters with one country. This means that the culture, legal and regulatory barriers, foreign government and other business case matters must be understood and factored in when achieving company and interactions through business deals. Applying an international strategy involves entering a new market without significantly changing product features or pricing strategy. Products or services are sold at similar price points and with the same branding, functionality, and design.

4.10 KEYWORDS

- **International Business:** Any firm that engages in international trade or investment.
- **Business strategy:** It is the strategic initiatives a company pursues to create value for the organization.
- **Global expansion:** It is the process by which companies from one market (often referred to as their home market) expand operations into a foreign market.
- **International Strategy:** Exporting or importing goods and services while maintaining a head office or offices in their home country.
- **Multi-domestic Strategy:** focuses on creating multiple, country-specific brands instead of one global brand, and involves developing different sales tactics, marketing strategies, and product portfolios based on the local market.
- **Transactional Strategy:** It is a business strategy that focuses on single, "point of sale" transactions.
- **Market Research:** Blends consumer behavior and economic trends to confirm and improve your business idea.

4.11 SELF ASSESSMENT QUESTIONS

1) What is international strategy for global expansion and further explain strategic considerations of international business?
2) Explain Four types of international strategies?
3) Explain the benefits of global business expansion?
4) Explain the methods of global expansion?
5) Explain the use of the PESTEL framework?

4.12 SUGGESTED READINGS

1. International Business, 9th Edition, Michael R. Czinkota, HB, Higher Education from Cambridge. ISBN: 9781108476744

2. International Business: The Challenges of Globalization (Paperback) by. John J. Wild. Pearson, 2016, Paperback, ISBN: 9781292095042

3. International Business Development: A Concise Textbook Focusing on International B-to-B Contexts, Ludwin Marting, Springer Gabler; 1st ed. 2021 edition (2 July 2021), ISBN-10: 3658332204.

4. International Business, Dr Rakesh Mohan Joshi, Oxford University Press; Illustrated edition (7 May 2009) ISBN- :978-0195689099

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LESSON-5

INTRODUCTION AND CONTROL SYSTEMS

OBJECTIVE

- The top management can be provided with hints and ideas for better managing, evaluating and monitoring the objectives in order to achieve the goals of the organization.
- Hints and ideas can be obtained with which the units can coordinate properly and common objectives can be achieved.
- The performance of the managers can be evaluated.

STRUCTURE

5.1 Introduction
5.2 Definition International Business
5.3 Internationalization of Business
5.4 Advantages of Internationalization
5.5 Control System
5.6 Control defined in the words of Henri Fayol
5.7 Advantage and Disadvantage of control system
5.8 Control System Overview
    5.8.1. Planning
    5.8.2 Action
    5.8.3. Delegation of Authority
    5.8.4. Information
5.9 Different Types of Control Mechanisms
    5.9.1 Personal Controls
    5.9.2 Bureaucratic Controls
    5.9.3 Output Controls
    5.9.4 Cultural Controls
5.10 Control Mechanisms approaches
    5.10.1 Market Approach
    5.10.2 Rules Approach
    5.10.3 Corporate Culture Approach
    5.10.4 Reporting Culture
    5.10.5 Visits to Subsidiaries
    5.10.6 Management Performance Evaluation
5.11 Summary
5.12 Keyword
5.13 Conclusion
5.14 Self Assessment Questions
5.15 Further Reading

5.1 INTRODUCTION

The world is fast becoming a global village where there are no boundaries to stop free trade and communication. Keeping pace with it, the way we do business has changed in an unprecedented manner. The competition, in the global marketplace, is at its peak where all companies want to sell their goods to everyone, everywhere on the globe.

For example, the faucet we see in our bathroom may be from Italy. The towels we use may be a Brazilian product. The automobile we drive may be a Japanese or German brand. The air conditioners we use may be from France. It is almost impossible to stay isolated and be self-sufficient in this day and age. That is why multinational companies are a reality.

5.2 DEFINITION INTERNATIONAL BUSINESS

Any business that involves operations in more than one country can be called an international business. International business is related to the trade and investment operations done by entities across national borders.

Firms may assemble, acquire, produce, market, and perform other value-addition-operations on international scale and scope. Business organizations may also engage in collaborations with business partners from different countries.

Apart from individual firms, governments and international agencies may also get involved in international business transactions. Companies and countries may exchange different types of physical and intellectual assets. These assets can be products, services, capital, technology, knowledge, or labor.

Note : In this tutorial, we are primarily focusing towards business operations of the individual firm.

5.3 INTERNATIONALIZATION OF BUSINESS

Let's try to explore the reasons why a business would like to go global. It is important to note that there are many challenges in the path of internationalization, but we'll focus on the positive attributes of the process for the time-being.

There are five major reasons why a business may want to go global –

- **First-mover Advantage** − It refers to getting into a new market and enjoy the advantages of being first. It is easy to quickly start doing business and get early adopters by being first.
- **Opportunity for Growth** − Potential for growth is a very common reason of internationalization. Your market may saturate in your home country and therefore you may set out on exploring new markets.

- **Small Local Markets** − Start-ups in Finland and Nordics have always looked at internationalization as a major strategy from the very beginning because their local market is small.

- **Increase of Customers** − If customers are in short supply, it may hit a company's potential for growth. In such a case, companies may look for internationalization.

- **Discourage Local Competitors** − Acquiring a new market may mean discouraging other players from getting into the same business-space as one company is in.

5.4 ADVANTAGES OF INTERNATIONALIZATION

There are multiple advantages of going international. However, the most striking and impactful ones are the following four.

Product Flexibility

International businesses having products that don't really sell well enough in their local or regional market may find a much better customer base in international markets. Hence, a business house having global presence need not dump the unsold stock of products at deep discounts in the local market. It can search for some new markets where the products sell at a higher price.

A business having international operations may also find new products to sell internationally which they don't offer in the local markets. International businesses have a wider audience and thus they can sell a larger range of products or services.

Less Competition

Competition can be a local phenomenon. International markets can have less competition where the businesses can capture a market share quickly. This factor is particularly advantageous when high-quality and superior products are available. Local companies may have the same quality products, but the international businesses may have little competition in a market where an inferior product is available.

Protection from National Trends and Events

Marketing in several countries reduces the vulnerability to events of one country. For example, the political, social, geographical and religious factors that negatively affect a country may be offset by marketing the same product in a different country. Moreover, risks that can disrupt business can be minimized by marketing internationally.

Learning New Methods

Doing business in more than one country offers great insights to learn new ways of accomplishing things. This new knowledge and experience can pave ways to success in other markets as well.

Globalization

Although globalization and internationalization are used in the same context, there are some major differences.

- Globalization is a much larger process and often includes the assimilation of the markets as a whole. Moreover, when we talk about globalization, we take up the cultural context as well.
- Globalization is an intensified process of internationalizing a business. In general terms, global companies are larger and more widespread than the low-lying international business organizations.
- Globalization means the intensification of cross-country political, cultural, social, economic, and technological interactions that result in the formation of transnational business organization. It also refers to the assimilation of economic, political, and social initiatives on a global scale.
- Globalization also refers to the costless cross-border transition of goods and services, capital, knowledge, and labor.

Factors Causing Globalization of Businesses

There are many factors related to the change of technology, international policies, and cultural assimilation that initiated the process of globalization. The following are the most important factors that helped globalization take shape and spread it drastically.

The Reduction and Removal of Trade Barriers

After World War II, the General Agreement on Tariffs and Trade (GATT) and the WTO have reduced tariffs and various non-tariff barriers to trade. It enabled more countries to explore their comparative advantage. It has a direct impact on globalization.

Trade Negotiations

The Uruguay Round of negotiations (1986–94) can be considered as the real boon for globalization. It is considerably a large set of measures which was agreed upon exclusively for liberalized trade. As a result, the world trade volume increased by 50% in the following 6 years of the Uruguay Round, paving the way for businesses to span their offerings at an international level.

Transport Costs

Over the last 25 years, sea transport costs have plunged 70%, and the airfreight costs have nosedived 3–4% annually. The result is a boost in international and multi-continental trade flows that led to Globalization.

Growth of the Internet

Expansion of e-commerce due to the growth of the Internet has enabled businesses to compete globally. Essentially, due to the availability of the Internet, consumers are interested to buy products online at a low price after reviewing best deals from multiple vendors. At the same time, online suppliers are saving a lot of marketing costs.

Growth of Multinational Corporations

Multinational Corporations (MNCs) have characterized the global interdependence. They encompass a number of countries. Their sales, profits, and the flow of production is reliant on several countries at once.

The Development of Trading Blocs

The 'regional trade agreement' (RTA) abolished internal barriers to trade and replaced them with a common external tariff against non-members. Trading blocs actually promote globalization and interdependence of economies via trade creation.

5.5 CONTROL SYSTEM

A control system is the one which manages, commands also directs, or regulates the behaviour of other departments or systems in a company.

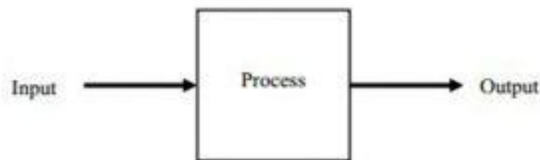
For continuously devised control systems, a feedback control system is used to automatically control all the processes in an organization.

Control System in an organization is very essential, before hitting to the main elements to be present in a good controlling system, first let us know what actually this control system in an organization means.

For any business, control mechanisms are crucial. Control is very essential with respect to the role played by the manager, and for achieving the goals as desired and planned. The goals are being achieved as the decision-making process and performance of the organization is influenced by the instruments being provided by the control mechanisms. For all the organizational activities in attaining the expected results, certain regulations are applied, which is known as control.

With respect to the functions, attributes of the product and geographic, and strategic and financial objectives, control mechanisms can be set.

Control system is a way of arranging and combining components in such a way that the desired output is obtained. In other words, a system is said to be “controlled”, if it’s working in a stable mode without getting unstable in any span of time.



A control system can be functioned electrically, mechanically, pressure by fluid (gas or liquid), or it can be combination of these ways. But it more preferred to operate this system by electrical means especially when computer is involved, even though interfusion are common these days

5.5.1 Control

Finally, you have the concept of *control*. As stated above, control is one of the functions of management. In this context, it refers to the process of analysis and corrective action. When controlling, you are essentially monitoring whether you are receiving an expected result of a process (or during it) or if the outcome deviates from the expectation.

If there is a deviation, you take corrective action to ensure the expected results occur. Previously, the concept of control was mainly focused on correction *after an error had occurred*. In the example of the shoe production, you would notice there was a deviation when you count the shoes and instead of getting 1,000, you've made 999.

But with the rise of modern technology, control can be used to *foreseeing an error*. This has changed the function and made it increasingly important part of the management process. For example, your shoe production facility might have monitoring systems that help you realize the shoes are not being finalized as quickly as they should in order to make 1,000 pairs. You are essentially able to see that you would encounter a problem; instead of just realizing a problem has occurred.

If you consider the process in the forms of steps, **control in relation to management** would look like this:

- **Setting a goal and establishing desired objectives.**– "I want to create 1,000 pairs of shoes in a month."
- **Measuring the achievements of goals and objectives**.– "I've made 999 pairs of shoes in a month."
- **Comparing the achieved goals and objectives with the original goals and objectives.** – "I wanted 1,000 and I got 999. I wanted to do it in a month and I've spent a month."
- **Analyzing variances and reporting on them. Determining the underlying causes for the variations.**– "I'm one pair of shoes short, but I've met the deadline. I did not have enough materials on day two and I got behind in my goals."

- **Taking corrective action to eliminate the variations.**– "I've recalculated the requirements for fabrics and I've ordered enough for next month."

- **Following up and repeating the process.**– "I've now created the right amount of shoes every month."

5.5.2 Systems

What about systems? As mentioned above, you can view organizations as systems. The Business Dictionary gives two definitions to systems, which are both good to understand in the context of MCS. Systems are:

"*a set of detailed methods, procedures and routines created to carry out a specific activity, perform a duty, or solve a problem*"

or you could view them as: "*an organized, purposeful structure that consists of interrelated and interdependent elements*"

The key to systems, especially in the case of MSCs, is the structure of which they are formed and often perform. Every system comes with input, output and feedback mechanism. The system is able to maintain itself even when the surroundings are changing and it has a specific set of boundaries within which is operates. The picture here illustrates the idea of a system in a business context perfectly.

You have an input, the business system and the output. You also have the feedback mechanism. The business system would be the strategy the business uses to create a specific output. If the output is to provide cheap shoes, the business strategy is manufacturing of the shoes with the specific elements this entails.

The input, therefore, is the resources (materials, labor, equipment) you need to achieve the output. So, you take the resources, you implement them with your chosen strategy and you get the results. The results then provide feedback to inputs on the performance of the system. Perhaps you didn't receive as many shoes as you wanted and so, you can increase input. For example, buy more materials, hire more people and so on.

SYSTEMS THINKING

Systems have feedback loops and the system must react to this feedback

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The objective of the system is to achieve a pre-determined result each time it is executed.

In a business environment, the sale process can be viewed as an example of the process. The organization has a set of policies and processes in place to guarantee the sale effort would always lead to a same result (i.e. the sale). As mentioned in the above section, management would be one of the methods used to guarantee the result occurs in the system each time.

In the case of the example above, your pre-determined result might be to have 1,000 good quality shoes with an individual shoe costing $50 to make. The feedback might show you that occasionally the cost of shoes rises to $70 and you know you need to tweak the input or the processes you use, as you've deviated from the wanted results.

5.6 CONTROL DEFINED IN THE WORDS OF HENRI FAYOL

Monitoring of the activities to ensure that the activities are as planned and the orders are properly given according to the laid out principles. The main objective of control is to identify the mistakes if any and rectify and also prevent the recurrence of the mistakes.

5.7 ADVANTAGE AND DISADVANTAGE OF CONTROL SYSTEM

There are many advantages and disadvantages of control systems in business management. These control systems should be thoroughly examined and applied in order to be a successful manager and have a business run smoothly. The types of control systems are bureaucratic control, market control, and clan control.

Bureaucratic control uses "formal rules, standards, hierarchy, and legitimate authority", and this type of control system works well with specific tasks that are done by independent workers (Bateman & Snell, 2009, p.34). Many businesses utilize this form of a control system in management.

Market control uses “prices, competition, profit centers, and exchange relationships” to establish control, and it works well where “tangible output can be identified and market can be established between parties” (Bateman & Snell, 2009). This type of control system is unpopular because the constant fluctuation of the market causes complications with the security of this control system.

Clan control involves shared culture, beliefs, standards, and trust. This control system works best where no one is strictly the decision maker and employees are encouraged to provide input, make choices, and act independently. This is a new control system that is starting to become popular with the increased need for innovation.

Some advantages of bureaucratic control systems are lack of confusion about decision making and lack of confusion in expectation and standards required from employees. This type of control system has clear management rules and responsibilities are cut and dry. Disadvantages of this system are lack of employee morale and lack of room for change and innovation. Independent workers and strict guidelines can make employees feel undervalued, and this is a disadvantage for business and management.

An advantage of market control systems is a flexible system, but this is also a disadvantage because value is always changing and employees may suffer from companies being repeatedly bought and sold. Flexibility can be positive one day and detrimental another, and human capital is at risk with this type of control system.

A clan control system is advantageous because it provides a company with more possibilities of innovation and ideas, but it lacks a direct form of control or strict authority which can lead to confusion of responsibility. Lack of standard management can cause problems in business when using this control system because employees may slack, take advantage, or shrug responsibility with out guidelines. This control system is advantageous to business and management because it can also encourage employees to take initiative and increase knowledge and skills.

Control systems are valuable to management in business, and understanding the three basic control systems is important when implementing a control system in a business. The disadvantages and advantages of each control system must also be considered when choosing a system for business management.

5.8 CONTROL SYSTEM OVERVIEW

In every organization it is mandatory to have a good control system. An assured control system only comes with good elements present in it, the selective elements are as follows

5.8.1. Planning

Planning and control are closely connected to each other. Planning without controlling is meaningless and controlling without planning is acting blindly. Planning provides the base for control. Control brings focus to all bottlenecks related to work performance and this operates as a

straight pin to the requirement of the situation. It is thus related to the planning function of the manager. Control is the result of all set plans, goals or policies. Thus, we see planning offers and affect control. Properly devised plans become important elements in bringing strong control.

5.8.2 Action

Control suggests what actions can be taken to correct the deviation that might occur between the standards and the actual results. Definitely, it should assume the role of an emergency handler who comes into action right when it is the urgency. But deviations do occur in spite of the best guiding from the manager. In such a situation, the manager should be vigilant in his act. He should be quick not only in identifying the deviations, but also in rectifying them with the correct ones. Thus, control means the required and quick action to correct differences or actions which at least try to prevent such variations in future.

5.8.3. Delegation of Authority

Delegation of authority only means to grant the authority or power to the subordinates to operate within the prescribed limits. Control means the authority to get the performance and detect it's deviations and then to take the necessary corrective action. A manager cannot exercise control without the adequate authority. He also has a need to control the operations which are exercised by taking action which may be taken within the limits of his authority. The best policy of delegation is the matching of equitable responsibility and authority. It also suggests that a manager must have corresponding authority as compared to his own responsibility.

5.8.4. Information

For an effective control system, there must be a prompt flow of information to the manager. Managers in the organization must have adequate information about the performance, standards, and resources being contributed to the achievement of the organizational objectives. The system of communicating back to the manager is called a "feedback" system. An effective feedback system helps the manager to know where and when the deviation from any plan took place. This can then initiate a prompt corrective action. Promptness in reporting and information is vital for quick remedial action.

Thus, we see there are these elements which form an effective control system. Every organization must make sure about this system of control in order to control all the resources in the department.

5.9 DIFFERENT TYPES OF CONTROL MECHANISMS

The control can be performed by using various modes. Some of the most effective methods of control are as follows -

5.9.1 Personal Controls

By maintaining personal relations with the subordinates, the person control mechanism can be practices. Mostly small business practices these personal controls such that the operations of the employees can be managed by direct supervision. In Multinational companies, personal controls help in building the relationships between managers with other employees of the organization. The way in which the subordinates behave can be influenced by setting up the personal control policies.

5.9.2 Bureaucratic Controls

The international businesses which are inbuilt with bureaucracy usually follow the bureaucratic controls. The functioning and actions of the sub-units are being influenced by some of the rules and procedures laid out by this mechanism.

For spending of capital, certain rules have been formulated which requires the prior approval of the top management for the capital to be spent.

5.9.3 Output Controls

Certain goals have been formulated with respect to the subordinates in such a manner that subordinates working in different departments achieve the output as targeted. These goals set are known as output controls.

The output controls are measured on the basis of some of the parameters such as productivity, profitability, market share, product quality etc.

5.9.4 Cultural Controls

The output and profitability can be achieved by maintaining a proper corporate culture. Therefore it becomes very essential to measure the efficiency of the business and hence cultural controls become important.

The cultural control rules that are being set enable an employee to self-control the behaviour thus the work of the superiors with regard to supervision is reduced, thus reducing the requirement of other control mechanisms.

5.10 CONTROL MECHANISMS APPROACHES

A business can be controlled by following different approaches. Some of such approaches to control the business are as follows -

5.10.1 Market Approach

The control mechanism is formed and the management behaviour depends on the external market forces. The business organizations which have a decentralized culture usually practice the

market approach. Market approach facilitates in easy negotiations for the transfer prices. The different market forces direct and govern the decision-making process in this approach.

5.10.2 Rules Approach

The organization that is rules-oriented where the rules and procedures are followed for the purpose of decision-making applies this rules approach. This approach requires a developed plan along with a budget system. The combination of both the input and output controls are used by this rules approach.

5.10.3 Corporate Culture Approach

A set of values are being built for the employees to achieve the goals internationally by the business that follow the corporate culture approach. The operations of the business are mostly influenced by this corporate culture approach. Some of the organizations tend to be more informal and lack explicit in spite of practicing the corporate culture approach. The corporate culture approach does not accept the change quickly.

5.10.4 Reporting Culture

One of the most powerful control mechanisms is reporting culture. When the resources are distributed and when the performance of the business and employees has to be monitored and reviewed by the top management, reporting culture is used. This control mechanism usually involves rewards for the employees. But this control mechanism tends to be more successful only when the reports have correct and accurate information.

5.10.5 Visits to Subsidiaries

By visiting to subsidiaries, the control can be done but one major disadvantage is that all the required information cannot be exchanged y this control mechanism. In order to better under the local management the corporate staff usually practice this approach. By visiting, information about the business can be gathered and accordingly can be advised.

5.10.6 Management Performance Evaluation

The subsidiary managers are evaluated on their levels of performance by the management performance evaluation approach. The mina limitation of this approach is that only some of the aspects can be controlled and not all the aspects. This kind of approach is best suited for the economic and political environment which is more risky.

5.11 SUMMARY

Management control is important for organizations because failures in management control can lead to large financial losses, reputation damage, and possibly even to organizational failure.

Despite the importance of having good management control systems (MCSs), management critics have argued that adding controls does not always lead to better control and that the MCSs in common use cause managers to be excessively short-term oriented or are prone to stifle creativity and initiative.

An old narrow view of a MCS is that of a simple cybernetic (regulating) system, involving a single feedback loop (thermostat). This book takes a broader view and recognizes that some management controls are proactive rather than reactive. Proactive means that the controls are designed to prevent problems before the organization suffers any adverse effects on performance. The benefit of management control is that the probability that the firm's goals will be achieved increases.

5.12 KEYWORD

- Control
- System
- Management
- Authority
- Planning
- Bureaucratic

5.13 CONCLUSION

This chapter explains elements of organizational design that are vital for executing strategy. Leaders of firms, ranging from the smallest sole proprietorship to the largest global corporation, must make decisions about the delegation of authority and responsibility when organizing activities within their firms. Deciding how to best divide labor to increase efficiency and effectiveness is often the starting point for more complex decisions that lead to the creation of formal organizational charts. While small businesses rarely create organization charts, firms that embrace functional, multidivisional, and matrix structures often have reporting relationships with considerable complexity. To execute strategy effectively, managers also depend on the skillful use of organizational control systems that involve output, behavioral, and clan controls.

Although introducing more efficient business practices to improve organizational functioning is desirable, executives need to avoid letting their firms become "out of control" by being skeptical of management fads. Finally, the legal form a business takes is an important decision with implications for a firm's organizational structure.

5.14 SELF ASSESSMENT QUESTIONS

1) What is meant by System?
2) What is meant by Control System?
3) What are the types of control system?
4) What is open loop and control loop systems?
5) What is time-invariant System?
6) What are linear and non-linear systems?

7) What is meant by analogous System?
8) What is the Transfer Function?
9) What are the advantages and disadvantages of open loop control System?
10) What are the advantages and disadvantages of closed-loop control System?
11) What is an order of a system?
12) What is the resonant peak?
13) What is the cut-off rate?

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LESION- 6
MEASUREMENT AND EVALUATION OF PERFORMANCE MULTINATIONAL CORPORATE CULTURE

OBJECTIVES

After going through this unit, you should be able to:

- Understand the precise meaning of performance of international firms and firms engaged in international business (both styled as international firms in this unit).
- Identify the parameters which determine the performance of firms, underscoring the distinguishing elements applicable to international firms.
- Learn about the tools and techniques used for the measurement and evaluation of enterprise performance.
- Comprehend the significance of the tools and the limitations of their application.
- Apply the tools of measurement to the evaluation of the performance of international firms.

STRUCTURE

6.1 Introduction
6.2 Basic Concepts
6.3 Variables of Performance
6.4 Mechanics and Modalities
6.5 Tools and Techniques
6.6 Comparative and Historical Analyses
6.7 Productivity
6.8 Project Performance Evaluation
6.9 Socio-economic Performance
6.10 Performance Evaluation of International Trading
6.11 Evaluation Systems
6.12 Performance Evaluator
6.13 Prerequisites and Precautions
6.14 Performance of Transnational in India
6.15 Summary:
6.16 Keywords
6.17 Self-assessment Questions
6.18 Further Reading

6.1 INTRODUCTION

Shares of FERA companies (or foreign controlled companies) attract a very large number of investors in India. The public issue of the Tata-Timken equity was over-subscribed by a record, over 4000 times. The Reliance Industries at one time attracted 2,000,000 shareholders. Why?

There is one common answer. These companies performed better, or were perceived to perform better.

Practically every industry in India has some companies, which earn high rates of profits, and some companies which are sick. Obviously, the former perform better; the latter fail to perform. What is this performance? And how does one measure it?

Organisations are created to carry out specific functions for the achievement of certain goals. The basic goal of any commercial enterprise (or firm) is to produce and market goods and services, and earn profits. The production and marketing involve investment of resources in terms of technology, management, materials and manpower, all eventually translated and expressed into monetary terms.

A successful organisation is one which produces high returns on its investment Every investor (of resources) wants to maximise his return over short and long periods. The return reflects the ultimate performance.

Is there any one unique indicator of performance? If yes, what is that? If not, what are the different parameters of performance? How are they measured? What are the tools used to measure them? And using these tools, how do we evaluate the performance?

6.2 BASIC CONCEPTS

International business is composed, basically, of four types of operations:

1) Production of goods (agro, manufacturing, mining, forest-based or marine products).

2) Marketing (marketing of products or services).

3) Services (such as contracting, consultancy, advertising, banking, insurance).

4) Exports and imports of goods and services (international trading).

The organisational goals and operating structures are divergent in each case. So are their tools of performance, parameters of performance and performance evaluation. This does not imply that there are no commonalities. In fact, the final goal of business organisations is the same, and each involves the same inputs (capital, technology, management, materials and human resource).

International business is carried out by four types of firms:

1) Wholly domestic or joint international firms engaged in

a) international trade in goods and services,
b) performing services in other countries.

2) Domestic firms with international capital or technological collaboration.

2) Foreign-controlled companies operating in host countries (multinationals or transnationals)

a) as branches,
b) as locally incorporated companies (subsidiaries),
c) as participative companies with the majority or minority of domestic capital.

4) Joint ventures between domestic and foreign firms operating in one or more of the participating countries or in the third countries.

Performance

If the goal of an enterprise is to maximise its return (on investment of resources), and its performance measures this return, its measurement is cardinal to (i) investment decisions; (ii) decisions relating to organisation structure; (iii) operational decisions - on product (or service), which it should produce, production planning, marketing, financial management, human resource deployment and development. Since an enterprise is a living organism, which operates, grows (or contracts), diversifies, interacts, it may perform better during one period, and not so well during another period. It is often found that one constituent of a company performs well, while the other or others do not perform so well. Swadeshi Polytex, a company owned and controlled by the National Textile Corporation (UP) Ltd: produces profits, but other units of the company produce losses. A company may have achieved higher' ales during a specific period, but it makes less profit (or more losses) during the same period.

International business, like any other business, is expected to perform for the benefit of

1) macro-economic objectives, and
2) micro-corporate objectives.

The present Unit is concerned primarily with the second.

The performance may be viewed from the point of view of return on invested resources (ROI) or operational efficiency of the inputs deployed in the organisation. In the first case, it is the total return of the enterprise; in the second case, it is the net output of a specific input or a group. Since the net output is dependent on the contribution (inputs) of others, it is necessary to segregate the contribution of others, while measuring the performance of a specific individual or group. Put in a different context, performance is a synonym of productivity. It is measured at four tiers:

- individuals,
- a group,
- the organisation itself, and
- a conglomeration of organisations.

Performance of intangibles (like technology) may also be measured. It reflects, however, in the performance of the agents (supplying, managing or operating it). The performance evaluation at the four designated tiers should take full cognisance of the contributions of intangibles as technology and management systems.

The performance of each, an individual (say, a production manager), a group in the organisation (say, Hindustan Lever Ltd.), or a group of companies (say, all Japanese multinational companies operating in India), has its own significance and ramifications and calls or specific treatment. For convenience, the four-tiered structure could be termed:

1.	**INDIVIDUAL** performance.
2.	**FUNCTIONAL** (or group) performance.
3.	**CORPORATE** (or organisational) performance.
4.	**SUB-SECTORAL** performance.

Since the horizon of the operation at each tier is different as is the intermediate goal divergence, the indices of performance are different too. In theory, the performance of any group, organisation or a defined agglomeration, is the sum total of the performance of its constituents, but it is not always so. First, the performance of a constituent is often not measurable in terms of the performance indices of the group. Profit is an index of performance of a profit centre (group or company), but it is not one of a servicing unit (such as a maintenance unit). Moreover, an individual earns profits only by the combined contribution of others. Secondly, there is normally a synergy in the organisational structure: the output of a group has a multiplier (sometimes negative) over the performance of the sum total of the constituents of the group.

The present Unit excludes the treatment of Individual Performance, which is a function of Personnel Management. It has its own objectives, tools, indicators and appraisal systems.

Since performance measures productivity, and productivity is the ratio of output to input, performance is measured in terms of output. If outputs and inputs were all homogeneous and quantifiable, the task of performance measurement would have been simple. Both inputs and outputs are often expressed in heterogeneous terms. Accordingly, it is not easy to measure productivity (or variations in it); and, therefore, performance. Another complicating element is the variability of the media in which different components of the outputs can be expressed. It is, therefore, necessary to identify the goals of performance at each tier, and then translate the output (or performance) in terms of these goals.

Performance evaluation is a four-stage operation

Fig. 8.1: Stages of Performance Evaluation

Stage	
I	Identify Parameters
II	Identify Tools/Indicators
III	Measure Performance
IV	Evaluate Performance

Parameters and Indicators

Performance parameters are performance values denoting different outputs, such as, sales and employment. Indicators are the relationships of outputs **inter se** or with other inputs, such as, profitability, productivity, debt-servicing ratios. Indicators provide the tools for measurement of performance. In common panlance, the terms "parameters" and "indicators" are often used interchangeably. Evaluation of performance is the assessment of the significance of the indicators in the context of corporate or segmental goals (objectives or targets).

6.3 VARIABLES OF PERFORMANCE

Transnationals may not necessarily be intrinsically better performers than domestic firms, but they possess externalities, which enables them to earn higher profits, says one recent study. This raises two issues: first, that the transnationals do not possess any intrinsic value, which make them better performers; secondly, that in measuring performance, it is necessary to segregate intrinsic variables from external variables. The latter aspect raises a further question:- what are the intrinsic variables and what are the external variables? And a corollary: is there any divergence between endogenous and intrinsic variables?

The variations between intrinsic and endogenous variables do exist. The former are specific elements organic to the organisation; endogenous variables are also speck to the micro unit, but may be influenced by external factors, such as, environmental conditions associated with the sector (spatial or otherwise) in which the candidate unit exists. The segregation, however, between intrinsic and endogenous variables is often not feasible in practical terms. It is, therefore, prudent to keep the distinction limited to endogenous and exogenous variables.

While enterprise performance is a function of both endogenous and exogenous variables, the dominance of one or the other set depends on historical as well as structural factors. They are often interactive. More significant variables are set out in Figure 8.2.

Figure 8.2: Factors Contributing to Performance

A.	Endogenous Variables	B.	Exogenous Variables
1.	Linkage benefits	1.	Policy environment
2.	Economies of size	2.	Industry structure
3.	Management skills/styles	3.	Inter-firm behaviour
4.	Management strategy	4.	Physical externalities
5.	Technology adaptation	5.	Technology status
6.	Corporate image	6.	Skills availability
7.	Brand image	7.	Product image
8.	Tie-ups	8.	International market access

The linkage factors are: (a) resource-oriented, (b) management centred, or (c) technology--related.

A conglomerate management has backward or forward linkages with the subject unit. When it has backward linkage, it gets preferential treatment in terms of price, quality or delivery against other competing units. When it has a forward linkage, it incurs lower costs, achieves better marketing access, and may be earns even higher prices. It may have, for example, the benefit of common storage facilities with its sister units.

Economies of size could result in a decisive comparative advantage. Transnationals, supported by group resources, often start with or operate large sized plants or marketing activities; every domestic unit (in developing countries) does not have that advantage. In times of glut in the market, the large size could be a disadvantage; but, by and large, it is not unless it is a continuous process plant.

Management skills and styles are very often the key factors in the performance of enterprises. The performance variances between public and private enterprises are attributed mainly to this factor. As observed earlier, in every industry in India, there are some firms, which make high ROI (rates of profits); there are others, which become sick, not only loss-making. It is due very often to relative quality of management skills and styles, which, in turn, varies with the management strategies.

An industry product has access to different technologies. A unit uses different technologies at different stages of production. Any one technology can make the whole difference in the performance. It is, therefore, necessary that the most cost- effective technologies are adopted for each stage of production. It is not always easy, however, to shift to new technologies because of replacement costs. Technology determines, not merely the total cost of the product, but has a direct bearing on the quality of the product - and the quality influences the price. Again, a specific technology could produce low or high material yield (output-to-input ratio) via wastage factor (of inputs) or rejections (of outputs), lower rate of production or low product quality.

Corporate and brand image may improve (or erode) turnover, or profit performance even when all other factors remain the same. Most transnationals score on this point.

External tie-ups, which can reduce cost, improve quality or increase production, could help in raising performance. The tie-up could be for input supplies technology, management expertise or marketing.

Exogenous Factors

Business policy environment is a common factor, which helps all units operating in a given market, whether it is a domestic firm or a transnational. It is, therefore, a differential factor mainly in imparting competitive advantage - or disadvantage - in the international context. Customs duty of over 50 to 80 per cent on capital equipment, and of over 100 per cent on raw materials and intermediates, imparted a decisive disadvantage to Indian manufacturing in export markets. Excise or production duty exemptions to small scale enterprises gave them a distinctive leverage within the domestic markets. Apart from cost components, the restrictions imposed on expansion of diversification of foreign enterprises forced stagnation of transnationals or FERA companies in India. Some of them faced very adverse conditions, such as, ICI (formerly, Chemicals and Fibres, Alkali Chemical Corporation and Indian Explosives).

Exogenous factors are related to

a) fiscal, monetary, industry and trade policies,
b) cultural patterns and social behaviour,
c) availability of skills and their costs,
d) availability of infrastructure and costs.

Activity 1

Take the case of any international company. Explain how individual performance is different from the firm's performance
……………………………………………………………………………………………………
……………………………………………………………………………………………………
……………………

6.4 MECHANICS AND MODALITIES

Ad hoc Evaluation and On-going Monitoring Systems

Performance evaluation could be undertaken on an ad hoc basis as a one-time exercise, or weaved into an information and monitoring system. While **ad hoc** evaluation exercises are commissioned as a tool for specific management decisions, it is often an expensive process. Cost and goal effective evaluation calls for the design of an on-going exercise as an information system, in which the feeding-in operation and retrieval form an interactive mechanism. In this on-going system, the performance evaluation itself tends to become an information system, and **vice versa.** A pre-designed operation, being a part of a MIS (Management Information System), receiving data inputs regularly in its normal process, is likely to be a cost-effective system.

When the performance evaluation becomes an on-going process, it takes the form of a Monitoring System.

A performance evaluation monitoring system should be specific in terms of

a) frequency (or periodicity)
(weekly, monthly, quarterly, annual);

b) contents or components
(parameters of performance to be evaluated);

c) processing techniques
(specifying the indicators to be used);

d) operating route
(from source and inputing procedures to processing and utilisation).

Single Versus Multiple Indicators

A single indicator, combining all components of performance, would appear to be the most desired target; In appraising new investments, one always looks for one rate of return, since it would be the most transparent and forthright aid to decision-making.

In other decision-making areas as well, one does not want to have qualifiers (IFs and BUTs) but a straight answer. Incidentally, socio-economic appraisal, although highly relevant, is avoided, in practice, mainly because it has to depend on multiple indices.

However, a single performance indicator is neither feasible nor desirable. It is not feasible, because it involves performance in terms of values, some of which are not quantifiable; and others, which are quantifiable, but are expressed in different denominations. Qualitative change in the corporate image, for example, cannot be expressed quantitatively. Similarly, productivity of an environmental change - in work culture or physical work environment - is not directly measurable in terms of monetary surplus (or profits).

Again, performance appraisal is required for different objects and different interests. A performance appraisal may be required for making technology improvement or for raising capacity or higher worker productivity. A price reduction will be welcome to a consumer; but it may reduce profitability.

A marketing manager is "interested in a higher turnover, a production manager in a higher output. A lendor wants a well-protected debt-servicing capability; an investor high returns on his investment; a Finance Minister higher tax revenues to the exchequer, or higher net inflow of foreign exchange.

There ought, therefore, to be multiple performance indicators. The multiple indicators alone can be used as tools of management decisions in respective areas.

Activity 2

Name three parameters of performance, showing how they can be used for specific management decisions.

…………………………………………………………………………………………

6.5 TOOLS A TECHNIQUES

Classification of Indicators

The performance indicators could be divided into four major groups based on the types of elements or parameters used :

Figure 8.3: Classification of Indicators

a)	Structural indicators
b)	Operating indicators
c)	Result-oriented (or profit) indicators
d)	Socio-economic indicators

Structural parameters of a firm are values (or quantities) of inputs, which are invested in a firm: equity and long term debt, for example.

Structural parameters do not, as such, reflect performance. Their variations and relationships, however, do. Thus, the value of fixed assets is no indicator of performance, but the variation in the value of fixed assets is. "If there is an increase in the value of fixed assets over a period of time, this is reflective of capital formationor growth. When it is compared with the rate of capital formation during the same period in a competing firm, it translates itself into the relative dynamics of the two firms, and, hence, becomes a performance indicator.

Among the operating parameters, the value or volume of sales is not a performance indicator; 'a variation in it is. Variation could be measured over time, against different products of the same firm or between similarly placed firms.

Operating parameters are the values (or quantities) of elements which, for example, are produced by a given investment, production and sales turnover. The line differentiating structural from operating parameters is often difficult to draw. Debtors when considered as amount of capital reinvested would be a structural parameter; when they are considered as a result of the current operations, that is, moneys not realised out of sales, it is an operating parameter. Similarly, employment is both a structural and an operating parameter.

Operating parameters do not directly reflect performance. These are proxies of some performance indicators.

Result-oriented indicators are the result of the operation of the firm in terms of surpluses. Financial profits are, of course, the basic profit parameter, when seen from the investor's point of view. Viewed, however, from a social (or national) angle, value added, employment and foreign exchange generation (especially in developing countries because of the scarcity of the last resource) are significant profit parameters.

Profit parameters may, therefore, be divided into micro-level and macro-level or social parameters. The distinction, again, between operating and profit parameters is often blurred as in the case of the foreign exchange earnings.

A caution, however, is called for in the interpretation of certain indicators: Increased employment generation is considered to be a desirable social profitability indicator; from that firm's point of view, it is e negative factor. More employment with the given volume of output means more cost, and, in fact, low productivity. The use of performance parameters, thus, calls for a certain amount of discretion.

For an international business firm, the generation of incremental employment and foreign exchange earnings for the hosts country is no objective to look for. Even a domestic firm may not be keen on this. From the standpoint of the host country, the performance of the foreign enterprises in terms of generation of employment opportunities and net foreign exchange earnings are significant indices. While this distinction needs to be recognised, the indicators have their own relevance depending on the specific objective of analysis and valuation.

It would, accordingly, be a more productive stray to bifurcate profit parameters into profit and social parameters.

Performance Indicators

Measuring tools are used according to the object of the appraisal and the relationships in the variables involved.

Ratio Analysis

Measurement of performance in financial terms frequently uses ratio analysis, which establishes the relationships between, two or more variables. The relationships are expressed as:

a) **a share,** normally expressed in percentages (e.g., raw material cost is 50% of total cost of production);

b) **a quotient** expressed as a numerical relationship, (e.g., number of persons engaged per tonne of output changed from 8.4 to 6.5 due to technology innovation);

c) **a coefficient (e.g.,** the share in cost-reduction of energy consumption is 0.45).

Financial ratio analysis has three dimensions:

a) Structural ratios,
b) Liquidity ratios, and
c) Profitability ratios.

Structural Ratios: The performance appraisal is not directly concerned with structural ratios (such as, debt to, equity, equity to net worth, equity to fixed assets, fixed assets to funded debt or liquidity ratios (such as, Acid Test ratio or current ratio). The structural ratios could be a contributory factor to performance but are not indicators of performance.

Profitability Ratios: Profitability ratios measure performance at intermediate or terminal points. The bottom line of any commercial organisation is profit (short term or long term), but several operating parameters lead to profitability. Without an effective control of these intermediate indicators, the terminal indicators cannot be controlled. The intermediate ratios are, therefore, equally significant.

Profitability ratio analysis could be based on the final determinant (net profit after tax-PAT) or relationships of profits with their components or other operating parameters.

The profitability ratios from the point of different investors are:

1) Operating profit.
2) Net profit.
3) Cash profit.
4) Dividend rate.

For an overall performance appraisal, the profit rates are the significant indicators generally, taken as the major indicators. The relationships among the four denominators may, briefly, be delineated as:

Operating Profit (OP)

minus	Interest
equals	Cash Profit (CP)
minus	Depreciation
equals	Net Profit (NP) or (PBT)
minus	Tax
equals	Profit after Tax (PAT)
minus	Dividend
equals	Retained Profit

In practice, the operating profit is not a fair index, since the interest cost is as much the responsibility of the operating managers" are the generation of operating profit (maximise revenue, minimise cost). Depreciation, however, is a part of the investment decision, and is not the responsibility of the operating mechanism. Moreover, depreciation is a historical cost incurred initially and, by and large, is -trot alterable from one operating period to another. It is not a cost which creates payment obligations. Accordingly, cash profit is a significant, if not a decisive, indicator.

Companies are owned by a multitude of shareholders. Reliance Industries Limited has had, at times, more than 2,000,000 shareholders. The company may be profitable, but if the management decides to pay low rates of dividend, the shareholders do not get adequate returns. And a public shareholder is not a perpetual investor. He invests in one company, and withdraws his investment after some time by selling his investment. What he gets as return (directly) is only the meagre dividend (which may vary generally from 20% to 80% of the profit earned). His indirect returns are reflected in the share price. But because of other constraints and general market conditions, the share prices might not increase. He has then to be content with the dividend only.

Tax planning has developed as a special expertise in policy regimes, such as that of India, where a large body of fiscal incentives and exemptions have been introduced. Tax is no longer a fixed flat outgo from profits. Again, what is distributable to the final investors (shareholders) is only the net profit after tax.

The 10-year returns of some leading firms of the USA (Table 8. 1), which are important transnationals, show the following tax efficiency ratios (net profit saved after tax):

Table 6.1: Returns of Some Leading. Transnationals of USA

Table 8.1 : Returns of Some Leading.Transnationals of USA

	Annual Return 10 years (%)	Tax efficiency co-efficient
Pepsico	26.97	0.95
Boeing	25.37	0.94
Ford Motor	27.89	0.93
Proctor & Gamble	20.91	0.92
General Electric	22.80	0.91
Du Pont	19.61	0.89
Exxon	22.07	0.87
IBM	8.70	0.82
Eastern Kodak	9.16	0.80
General Motors	10.94	0.78

To any international business entity, tax is of special¯importance. An investor has to reckon with two tax systems with interactive mechanisms - the tax system of the host and the tax system of the investing country. What the investor gets, finally, is what he is concerned with. (Some countries have double taxation relief treaties under which the tax is paid in the host country). In international trading transactions, customs duties - not production and monitoring costs - often determine international competitiveness.
Profit rates could be computed

a) on an accounting or accrual basis for a specific period, a month, a quarter, a half year, or a year, and related to the total investment;
b) on a discounted (DCF) basis for a specific time span, or for the life-cycle of the project or on specific investment.

The investment to which the profit is related under (a) is either the total capital employed or equity capital. The first measures the profitability (or operating efficiency) of the enterprise the latter the profitability of the venture capital (equity).

The rates of profits vary from one period to another, depending on endogenous factors intrinsic to the firm, the intensity and sources of competition and externalities, over which the management of the firm may or may not have any control. It is not rare to find many firms, which earn fairly large profits in the initial stages, witness a plateau or decline in their profits because of technological and other changes. Conversely, there are firms, which have long gestation and teething periods. But when the firm gathers its natural strength, it starts earning high rates of profits. The three entirely different scenarios are represented by the following cases:

	Firm A Rs mn	Firm B Rs mn	Firm C Rs mn
A) Capital Investment (t_{0-10} years of project life)			
t_0	450	900	150
t_4	300	—	300
t_7	150	—	450
	900	900	900
B) Average net cash (excluding A) inflows			
t_{1-3}	67	224	78
t_4–t_6	188	271	113
t_7–t_{10}	468	314	135
Total net cash inflows			
t_1–t_{10}	2637	2740	1113

The total capital investment is the same in each case (Rs 900 million). The rates of return however differ appreciably.

	Firm A	Firm B	Firm C
Accounting profits (%)			
t_1–t_3	15	25	52
t_4–t_6	25	30	25
t_7–t_{10}	52	35	15
Average	36	30	21

Internal Rate of Return (IRR) represents a standard DCF (discounted cash flow) technique, which is almost universally used in all professional investment decisions. The IRR tool does not distinguish between an investment rupee and an operating rupee, that is, between capital expenditure and current expenditure and capital receipts and revenues (or sales proceeds). It does not distinguish between venture capital and loan (or fixed return capital). It reckons with cash flows only - ignoring intangibles, including depreciation - and computes a specific return on capital flows - all inflows of capital and incomes and all outflows minus the outflows of the return on capital and costs.

IRR imparts time value to money. It recognises when the cash flows are generated (or dispersed). It assumes a rupee received (or spent) today has much higher value than the rupee which will be received (or spent) five years later.

IRR is the rate of return, which when applied to all cashflows (inward and outward) compounded by the time when they occur, yields a cash inflow, which is equal to all cash outflows. IRR may be expressed as

$$0 = \sum_{t-0}^{n} (CI - CO)_{at}$$

CI_t = Cash inflow in the year t
CO_t = Cash outflow in the year t
at = the discount factor

IRR is thus a real rate of return on the investments made after compounding the rates of -returns, depending upon when cash inflows and outflows take place.

IRR is used more as a tool for new investment decisions, but it could be a much more useful tool for performance evaluation. It shows how operational results have behaved effectively - not only on a gross basis.

Cost Ratios
Segmental financial ratios can take the form of cost components. Examples: Ratios of

1) Material cost)
2) Energy cost) to
3) Manpower cost) TOTAL VALUE OF
4) Overhead cost) (OR TOTAL COST)
5) Marketing cost)
6) Financial cost)

Further analysis could be made by dissecting each component, relating it to the relevant segmental cost, such as, advertising or packaging cost to total marketing cost.

The performance of the firm is a reflection of other operating parameters, such as, better cash management, which is reflected in liquidity ratios as follows:

a) Current Ratio = $\dfrac{\text{Current assets}}{\text{Current liabilities}}$

b) Acid Test = $\dfrac{\text{Liquidity}}{\text{Current liabilities}}$

c) Inventory build-up : Inventory in terms of days of output

Profitability in the stock market is denoted by earnings per share

$$EPS = \frac{PAT}{Equity}$$

The stock market performance, inclusive of the image of the firm, is reflected by PE or the price-earnings ratio. Here the price is the current market price of the equity shares and

earning is the earning per share. The higher the multiple, the greater is the confidence of the investor in the firm's present and future operations.

A term lending institution (such as, Industrial Development Bank of India) would be interested not only in the profitability of the company, but also in its capacity to pay the instalments of loans and interest as scheduled. This is best measured by the debt- servicing ratio. It is a ratio of net cash generation in any given period after meeting all current and other obligations to the total sum payable against long term debts

6.6 COMPARATIVE AND HISTORICAL ANALYSES

Comparative Analysis

Comparative analysis is based on specific results of a comparable film or a standard firm or a competitive firm. The most valid comparison would be with a comparable firm: a firm similarly placed, that is, of a similar size, producing comparable products, and having the same exogenous benefits (and disbenefits). It is not always possible to find a wholly comparable firm.

A standard firm provides the more acceptable basis. However, it is also difficult to define and identity a standard firm. There are larger and smaller, better and not so- well located firms. There may, in fact, be no standard firm in the relevant industry. Again the data may not be available for a standard firm. An alternative course, therefore, is to simulate a standard firm.

There are two methods of simulation of a standard firm. The first is to locate **an average** firm. An average firm would be a "modal" firm. A simulated firm is one that belongs to the category of firms, which has the largest number of firms in the given industry. If 60% of the sugar mills have a dCC (daily cane crushing capacity) of 2500 to 3500 tonnes, 15% of upto 2500 dCC and 25% o over 3500 dCC, firms in the medium range capacity could be standard firms, This, however, will leave a wide choice, and the chosen candidate may not mid-point of the total range with an equal number of candidates above and below the median point).

The other method is to take the case of a well-performing firm or the best performing firm. The problem arises where the well-performing and best performing firms change their positions. In the absence of an accepted criterion, it is difficult to say which is a "well-performing" or a "best performing" farm.

Historical Analysis

historical trends measure performance ratios or parameters over a specific time-span (short term, medium term or long term). There are no universally recognised delimiters of short, medium and long terms. Broadly acceptable spans are:

a) Short term : Upto one year
b) Medium terms : Over one to five years
c) Long term : Over five years

The specific performance indicators are set at specific points of time or period spans. Time spans for short term are a month, a quarter, a half year. Time spans for medium term are generally annual. Long term periods are either annual or specific phases, such as, biennial, triennial or quinquennial.

The historical analysis can be by values (or ratios) and by time-trend analysis. When it is by values, like quantities are compared.

6.7 PRODUCTIVITY

While the bottomline of all commercial enterprises is the net profit (after tax), it is not always the result of the performance of the enterprise. External factors, especially the government policies, often distort the results substantially. An intrinsically valid measure is productivity.

Productivity is the output of a given quantum of inputs. The differential between the two is the net contribution. Since the differential is an absolute parameter, productivity, which is always a relative measure, is expressed as the ratio of net outputs to inputs.

Some productivity. studies have attempted - actuated probably by considerations of convenience - to take gross output as the numerator. This incorporates the contribution of the producers of inputs, but does not yield a true picture. When the gross value of textiles is the numerator for a weaving mill, it includes the "value added" contribution of the spinning mill, and even cotton, which is the contribution of agriculture.

Measurement of performance by the coefficient of productivity has one distinct advantage: it can be measured for the total enterprise or for different factors of production. When it is measured for the total enterprise, it is termed total factor productivity; and when it is measured for each factor, it is termed as partial factor productivity., Given the production function (f)

$Y = f(L, M, E, T)$

Where Y is net output,
L is labour input,
M is material input,
E is energy input,
T is technology input,
productivity is net output of input. The productivity of capital is synonymous with total factor productivity, since the total establishment is represented by capital investment.

Sometimes, capital or labour intensity is confused with capital or labour productivity. Labour and capital intensities are inter-factor functions, measuring each factor with the other, and are not the same as relative productivity. The former quantum of labour - measures per unit of capital or vice-versa, as the case may be.

On the other hand, energy intensity is normally related to capacity, although it could be related to output as well. When it is related to capital, it measures technology- efficiency; when related to output it spells factor productivity. However, it is relevant both to gross output as well as net output or value added.

Performance coefficient of productivity can be measured in financial as well as physical terms. It could be net output by value or physical quantity. It is particularly suitable for measuring performance of the workers (worker productivity). It could be conveniently applied to4functional groups, such as, marketing group (by relating the indicator to turnover).

It incorporates the contributions of technology and management as well. Less efficient management will keep the labour productivity low, howsoever more efficient the labour may be. Similarly, if technology is not efficient, or equipment is worn out or obsolescent, the labour productivity will tend to be low.

Partial or factor productivities thus measure the performance of the enterprise given a certain quantum of labour input, it is nor essentially the performance of labour. However, where other things remain constant, factor productivity does measure the variances in the performance of a given factor. If 900 workers produced a net output (NVA) of Rs 216 million, in 1991, and Rs 225 million, in 1990, with the same equipment and technology, there is a distinct improvement in labour productivity from Rs 2,40,000 per worker to Rs 2,50,000 per worker.

When productivity is applied to specific factors to measure partial productivity, it may be expressed in varying terms, such as, energy efficiency for productivity of energy, material yield factors for material productivity.

In measuring productivity, in terms of values, constant prices must be used.

Productivity, like any performance evaluation indicator is a relative measure. It could be used, historically, over short and long time spans, in comparison with competitors and with standard industry norms.

6.8 PROJECT PERFORMANCE EVALUATION

Project investments in new enterprises, or for expansion, diversification and modernisation of the existing establishments become profit centres when completed. Their performance until production commences cannot, therefore, be measured in terms of output or profits.

On the other hand, an effective evaluation system has to start from the beginning of the life cycle of the investment. Once the initial investment, which is substantial, has been committed, it produces a heavy impact on the operating results for a long period.

It has been observed that projects often suffer from large time and cost overruns. It is true, especially of international projects, which have to pass through inter-country regulatory measures in one or both countries, and involve external factors which are not too precise.

Projects are generally evaluated in terms of capital expenditures incurred. This is an erroneous approach, since it is not related to the work accomplished. When evaluated in physical terms, the process ignores costs involved. A given quantum of work (e.g. civil construction of 10,000 cubic meters) is completed within the scheduled timeframe, but might have cost more by Rs 2 million over the budgeted cost of Rs 20 million. Both methods do not take into account the efficiency of the project management (in terms of cost. and capital inputs in relation to work done or performance).

In the pre-investment estimates of a process plant project, the budgetary allocation for civil work upto June, 1984, was Rs 184 million. The actual expenditure was of the order of Rs 173 million upto that date. Two views were taken. The first one was that the project has lagged behind schedule since capital expenditure target on civil works was short by Rs 11 million. The second view was that there was a saving of Rs 11 million. In fact, both assessments were erroneous. The savings were due only to the deferment of foundation-laying, which was expected to cost Rs 20 million but would now cost Rs18 million. Even with the reduced cost of foundations, there was a cost overruns on civil works. There was, besides, a slippage in the time schedule (with deferment of the foundation-laying activity).

Slippages in project management occur due to a diversity of variables, which differ from project to project and from one component of a project to another. It also occurs in terms of inputs (material, manpower). A break-up is, therefore, necessary in accordance with the objectives of the project.

The alternative is the Value-based Project Monitoring (VbPM) System. VbPM seeks to establish relationships between the value of the work planned (VWP) and the value of work actually done (VWA). The value of work does not mean the monetary cost of work; it denotes the `real' quantum of work. Paradoxical as it may seem, the real quantum is sometimes measured in terms of monetary values. This becomes necessary, because the work to be measured is an aggregation of several component activities, which cannot have a uniform measure (for example, civil construction and machinery erection). The problem can be resolved by using `constant' prices. The prices at which the VWA is measured is the same as applied to VWP. This will not determine the cost overrun but slippage in work performance. To arrive at cost overruns, it will be necessary to escalate the physical slippage by price inflation

For a better understanding of the system, it may be appropriate to identify that costs of projects increase because of the following seven basic factors:

- price increase due to inflation,
- changes in project design (including technological and locational changes),
- deficiencies in project design and the need for post-planning revision,
- mistakes committed in construction and erection,
- non-availability of resources on schedule,
- less efficient management causing delays in implementation,
- externalities (factors beyond the control of project management).

It is obvious that the first step is the recording of data juxtaposed against the projected estimates. The data required are by activity and resource inputs. The values are to be recorded in physical quantities as well as values, both in current and constant prices: The extent to which the dissection of the data, in term; of activities and resource inputs, is needed would depend on the size of the project and¯the critically of the inputs and management objectives.

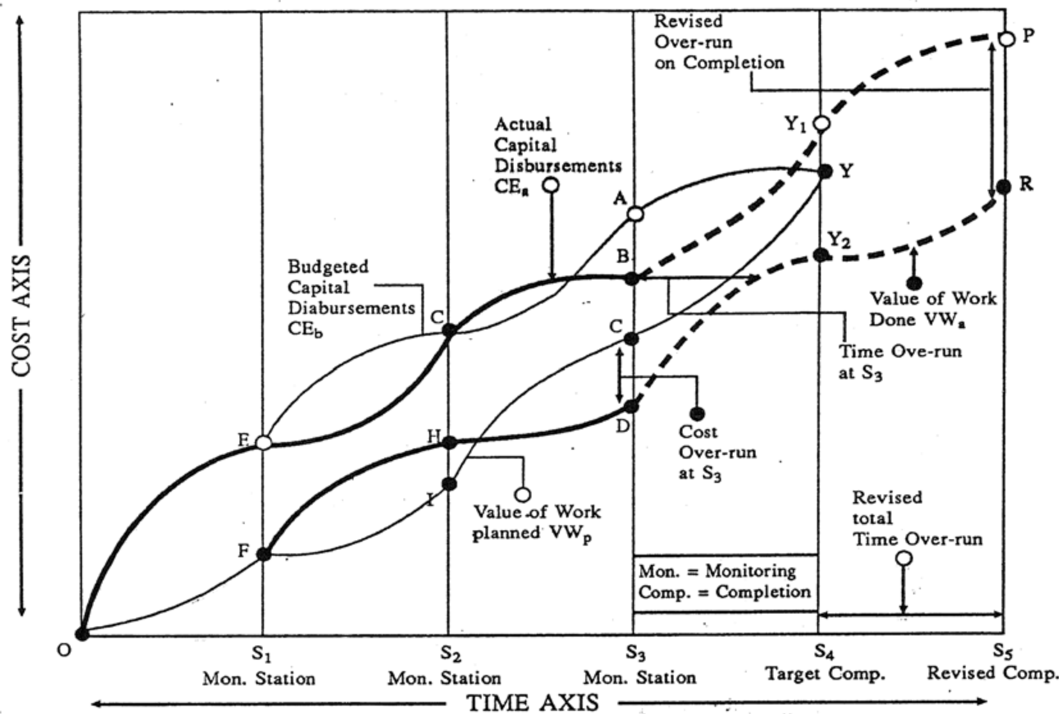
The analysis and appraisal is first geared to the identified activity centres. It is then extended to activity groups, and then to the project as a whole. The transcription of the data takes the form as shown in Exhibit 1, called "Value-based Project Monitoring Chart". This exhibit has been designed for the total project. The curves delineated are all cumulative.

The ordinates S1, S2, S3, mark the audit or monitoring stations in the time scale. There could be as many audit stations 'as the management finds effective. These should, nonetheless, be chosen with good care. Too many of them have been found to be distracting for the project team; too little to be ineffective.

The amount of overrun, at any point of time, is given by the vertical distance between the two curves VWP and VWA, and not between costs which is generally assumed.

Relative cost overrun (or underrun) of a project at any point of time may be expressed in percentage terms as

$$\frac{VWA-VWP}{VWP} \times 100$$



The exhibit also indicates the time over-run. It would be seen that the amount of delay at any particular point of time is given by the horizontal distance between curve S3 and intersection of VWA at the level of VWP. The curves also show progressive over-run or under-run of time.

The cost and time over-runs could - at any rate - be different for the future period. The value-based project monitoring chart enables re-drawing of the project scheduling and capital budgets, without which the project completion might encounter more adverse conditions. It is,

thus, not merely a performance evaluation tool, it can be deployed for re-planning of partially completed projects, which is the objective of performance evaluation

It is interesting to note that (see Exhibit) PR is greater than CD, which shows that the cost over-run will expand. This could be due to price escalation or direct cost expansion on account of interest cost and cost of project implementation, or both.

In order to get an idea as to how the project has advanced, activity by activity, the analysis could be disaggregated. On the basis of these curves, the management would know the activity which is behind schedule, and in which cost over-run is high to enable steps to be taken to avoid further slippages.

6.9 SOCIO-ECONOMIC PERFORMANCE

In the recent years, Cost-benefit Analysis (CBA) technique, which may be termed as social (or national) profitability analysis, has gained increasing ground. The latter is mistakenly assumed to be a substitute for commercial profitability. For any investment at the micro level, both are equally significant, although the latter, in practice, is not the required objective in private enterprise models.

In the 1970s and 1980s, it was believed that the CBA was a technique patently appropriate for public sector investment, which were to be solely guided by it. Since the late 1980s, with the increasing trust reposed in market-friendly economic models, the public sector investments are expected to earn first financial surpluses. In the ultimate analysis, it tantamounts to the weightage assigned to commercial profitability.

Serious doubts about the technique of the CBA were expressed even before the set-back to the public enterprise model was in evidence: first, the private investment decision was invariably a function of financial profitability (and not of social returns); secondly, the CBA was not amenable to easy mechanical analysis as is commercial or financial profitability (in terms of the IRR).

The CBA calls for a great deal of information on goods and services traded and not traded, internationally, and on domestic prices and on inputs including opportunity cost of labour, which are not easy to determine. There are other parameters, such as, social rate of discount (the social opportunity cost of capital), which are often subjective unless extensive analyses are undertaken.

The evaluation indicator for the CBA takes the form of the Social Rate of Return (SRR). The SRR is an extended version of the IRR, which

a) adds social costs and benefits (such as, net foreign exchange earnings, employment generation effects, distribution and welfare effects); and
b) transforms the internationally traded inputs and outputs at international prices.
   Once, the foregoing adjustments are made, the process is the same. Briefly, the following steps are taken:

1) **Start** with the cash flows - net inflows and,.net outflows - from the IRR computation.

2) **Add** to the inflows:
   a) premium on net foreign exchange earnings;

b) social benefits created by the project;
c) differential of net revenues if the domestic prices of outputs are less than the international prices;
d) taxes, direct and indirect, on inputs, outputs and incomes.

3) **Deduct** from the inflows
Social cost created by the project such as disbenefits from environmental pollution.

4) **Add** to the outflows
The differential of cost, is the domestic prices of internationally tradable inputs are less than the international prices.

5) **Deduct** from the outflows,

If opportunity cost of domestic outputs is more than what has been accounted for. Once the series of net outflows are arrived at, after making the foregoing adjustments, the series of the flows could be subjected to discounting technique to determine the SRR.

Since the process of determining the opportunity cost and the effects of externalities is very involved, something which calls for massive data inputs, it may be more practical to compute disaggregated socio-economic performance indices of performance. The more significant of these indices are given below.

A) **Net Foreign Exchange Earnings**

In most developing economies, except perhaps the oil exporters, foreign exchange (forex for short) is a critical scarce resource. Forex earnings, therefore, become a major objective. A commercial enterprise involves both earnings (through exports) and use of forex (for net outflows, at least, in the initial years. Net inflows and outflows of forex resources could be computed for short and long periods. When the net outflows are related to the forex used, it provides a useful indicator of the international impact of the investment.

The performance indicator will take the following form:

$$\frac{f_{in} - f_{of}}{f_{co}}$$

where fin is forex inflow, fof is forex outflows,
fco is initial forex investment:

In measuring the forex earnings, the opportunity cost (such as, saving through import substitution) has to be reckoned with.

B) Employment Impact

Every investment generates employment, direct and indirect. Since indirect employment (such as, for distribution network for a given output from manufacturing involves further investment), direct employment may only be taken. The indicator for direct

investment is the number of jobs created per unit of investment, say 58 man- years for every Rs 1 million of employment. This indicator can thus be expressed as

$$\frac{E(t, s, u)}{K},$$

where E is Employment in terms of man-years,
K is the unit of capital, say Rs one million, t is technical employment in man-years,
s is skilled employment in man-years,
u is unskilled employment in man-years.

The indicator should be expressed in man-years, since some industrial activities create only partial (or seasonal) employment.

C) Environmental Impact

The environmental impact is a major factor, which has so far been overlooked, but will gain increasing importance in the years to come. When a proper social cost- benefit analysis is made, it is a prime element. When disaggregated evaluation is made, the cost and benefits form the environmental point of view have to be computed. The problem arises where the effect is not measurable quantitatively - in physical or value terms.

Where the candidate activity creates pollution, of water, for example, the cost of effluent treatment could be computed. On the other hand, where the activity creates problems, such as, forest erosion, it has multiplier impacts, which cannot be easily quantified directly. Similarly, some activities could, in fact, reduce environmental pollutants. The benefit for this should be taken in the computation. An MDF (medium density fibres boards) project helps to clear cotton stalks (to be used as raw material) from the countryside; it makes a distinct improvement in the environmental conditions.

D) Technology.Upgradation

Induction of advanced technology imported from abroad by the multinationals is an additional benefit, which accrues to the country. The benefit is spread by horizontal transfer, training and upgradation of the manpower and by technical education. The impact is very difficult to quantify. Its impacts can be evaluated only qualitatively. Where induction of technology reduces cost or increased revenue via larger production or enhanced product quality, the impact gets reflected in the profitability coefficients

E) Value Added

The development of an economy is measured in terms of the growth in the GDP (the gross domestic product). The GDP is the sum total of the contributions of all economic activity in the country. It is, therefore, very meaningful to measure performance of a micro unit enterprise by its contribution to the GDP. This contribution takes the form of **value added.** Value added is the variance between the gross value of output and the material inputs used in the production.

Where Y is the gross value of output.

RM are raw materials, including auxiliary materials, components, process chemicals,

E is energy including fuel, PC is packaging materials,
D is depreciation.
When NVA is related to the investment, the coefficient shows the net productivity capital.

$$\frac{\sum NVA_{i-n}}{K}$$

6.10 PERFORMANCE EVALUATION OF INTERNATIONAL TRADING

International trading is carried out in
a) capital equipment,

b) intermediates

(including spare parts and processed materials)

c) raw materials
(agro, mineral, marine and other products)

d) technology, and
e) services (construction, consulting, insurance, banking, management, advertising).

The indicators delineated for manufacturing enterprises are applicable equally to all types of' business activities, and could be deployed with such adjustment as may be called for to suit the specific business goals and objectives.

The indicators, therefore, for a firm engaged in international trading are not different. Some special characteristics of such business need to be recognised :

a) The fixed capital investment of these firms are relatively small (relative to turnover) and working capital investment at large.

b) Since the fixed capital investment is relatively small, the short term gains (and losses) are of greater significance to these firms.

c) The performance of such firms is, by and large, more volatile, subject to major oscillation from one period to another.

d) These' activities have to be internationally competitive. Actual performance is vital for their existence and survival.

6.11 EVALUATION SYSTEMS

Three systems, which aid performance measurement and evaluation of an organisation are:

1) Budget Programming,
2) Management Audit,

3) PERT Programming,
4) MIS.

A firm's budget is prepared for planning (short term and long term) and financial control. The financial control is exercised by measuring deviations from the budgetary targets. Some budgetary exercises are, in fact, called Performance Budgets. The purpose of these budgets is to measure the performance in the preceding or past periods, and to make targets for the succeeding periods. Once the targets for each activity (and the total enterprise) are laid, it is easy to compute variance, and to measure current performance in relation to comparable performance in the past periods and in terms of targets.

Budgets are expressed basically in financial terms. But physical budgets are also designed and used, which provide a basis for evaluation in terms of physical quantities. Budgets are particularly useful for cost controls. The interlinkage between financial and physical budgets provide further basis for performance appraisal. Performance budgets, in fact, lay down the performance targets which become the bench-marks for performance appraisal.

Management Audit is an extended financial audit system, which monitors the quality of management decisions in financial operations. It does not stop at mechanical auditing of financial transactions, but enquires into the causation, modalities, results and impacts of the financial transactions. In effect, it appraises and audits the functioning of the management.

PERT (Programme Evaluation Review Technique) is based on CPM (Critical Path Method). It delineates a given project or programme into a network of activities and sub-activities with a view to optimise time. It computes critical activities with a view to optimise time. It computes critical activities (any delay in which would extend the total project schedule) and slacks (in activities which can be delayed if it helps in reducing costs). The sequencing of activities and their expected time-scheduling is integrated into a network identifying the critical path of activities and their optimal time scheduling. The value-based Project Monitoring System, discussed earlier, is based on such PERT network only.

PERT costing translates the time sequencing into a costing network, and could be used to monitor performance. The performance is measured by comparing the scheduled time and cost inputs with the actual time and cost inputs.

The Management Information System (MIS), as indicated earlier, is the on-going information system designed to plan, operate, appraise, monitor, control and redirect the total management, or the segmented activities of an enterprise according to pre- determined targets and goals. MIS is all-pervasive, and encompasses the financial and physical budgeting, management audit and control systems and PERT. Performance measurement and evaluation emanates from and converges on MIS.

6.12 PERFORMANCE EVALUATOR

Performance Evaluation is, or ought to be, based on objective information - generated in the course of business operations or specially collected for the purpose. The data collector is, therefore, the key to performance evaluation. The data processor is an extension of the data collector who uses statistical and logic systems to engineer an acceptable design of the data collected for evaluation.

The data collector and the data processor, however, are not the performance evaluators. The evaluation is made by a person or groups of persons in or outside the organisation. They take or help in taking investment or management decisions. The evaluator could be the Marketing or Production Manager, the General Manager or the lending agency (such as the IDBI, the Industrial Bank of India, and the World Bank), the Planning Commission. Undoubtedly, the decision-maker is frequently assisted by a host of assistants, executives and advisors. The support is essential since in most cases a multi-disciplinary approach is needed involving a mass of information and a diversity of indices, which are not always homogeneous and amenable to decision- making processes.

6.13 PREREQUISITES AND PRECAUTIONS

1) The objectives of performance evaluation should be defined precisely.

2) The candidate for performance evaluation - an individual, a group or a firm - should be clearly identified,

3) Performance evaluation should be period-specific. Performance can and does vary from one period to another.

4) Assumptions made in making the evaluation should be articulated without reservations.

5) The limitations of the evaluation indicators should be spelt in clear terms.

6) Each performance evaluation should be used for the specific purpose for which it is made. Any evaluation transposed for any other objective should be adjusted suitably.

7) Performance evaluation should be forthright, not open to different meanings or conclusions.

6.14 PERFORMANCE OF TRANSNATIONALS IN INDIA

A recent study on multinational corporations arrived at the following conclusions:

1) The transnational affiliates in India (ITNs) may not be intrinsically better performers than the indigenous firms, although they make more profits than the Indian firms.

2) Better performing ITNs have, however, special niches, which help them earn more profits.

3) The higher profitability of ITNs is secured in spite of the higher resources.

4) The higher ITNs profitability is due to (i) product differentiation (ii) goodwill through advertising, (iii) large sizes leading to economies of scale and superior

5) ITNs do not invest more in R & D, but have better access to the higher technology.

6) ITNs have better liquidity ratios, which is both the cause and the result of the higher profitability.

7) The export propensity (or performance) of ITNs has been lower than that of comparable Indian firms.

A Reserve Bank study of 326 foreign-controlled rupee companies (FCRs) and 2740 India controlled companies (ICCS) for the three years, 1985-86 to 87-88, shows, that the profits of the foreign companies were consistently higher in all the three years with their average being 10.37 per cent on sales against 7.56 per cent for the Indian companies. The variance was larger when the gross profit after tax is related to the net worth. The dividend record of the foreign companies is also better. This corresponds broadly to the profitability ratios.

	FCRCs			ICCs		
	85-86	86-87	87-88	85-86	86-87	87-88
GP to TO	10.9	10.2	10.0	8.2	7.7	6.8
GP to NA	12.9	12.0	12.0	7.9	7.1	6.3
PAT to NW	12.7	11.6	11.3	7.0	3.8	1.0
Dividend to NW	5.2	5.2	5.7	3.0	3.0	3.2

GP = Gross profit TO = Turnover NA-= Net assets NW = Net worth

6.15 SUMMARY

Performance measurement is a topic that has received considerable attention during the last decades. There are many motives for using performance measures in a company but perhaps the most crucial one is that they will help to improve productivity when used properly. Productivity is of vital importance to a company's ability to compete and make profits over time. A company that is not able to efficiently utilise its resources in creating value for its customers will not survive in the competitive business environment of today. However, the development of fully functional and suitable performance measurement systems (i.e. set of measures) has proven to be a very challenging task.

This research has focused on the last phase of the development of performance measurement system, namely the continuous updating of the performance measures, which still have not been explored in a satisfactory manner.

The objective is to investigate and clarify how to evaluate and revise performance measurement systems. In order to reach this objective, several obstacles that contribute to the complexity of the research area are treated. In the beginning, the thesis thoroughly investigates the confusing terminology within the field and frequently used terms like productivity, profitability, performance, efficiency and effectiveness are explained. Then, a categorisation of ways to measure performance is presented along with advantages and shortcomings of different productivity and other performance measures. Several key-factors found to affect the productivity of a manufacturing company are also discussed, such as: design of processes and equipment, disturbances and losses, management and control, product design, and job design and work organisation. Much attention is given to the different requirements that performance measurement systems must fulfil, both on the system level and the measure level. Finally a method called the performance measurement progression map is finally proposed, which has been developed in order to give measurement practitioners a comprehensive guide of how to evaluate and revise performance measurement

systems. The thesis is concluded with the results from several empirical investigations in which the usefulness of the developed method is validated.

6.16 KEYWORDS

Performance measurement, systems, Productivity, Evaluation, International Business, Trade, Value, Translation.

6.17 SELF-ASSESSMENT QUESTIONS

1) Distinguish between `Parameters of Performance' and `Indicators of Performance'
2) What is productivity? How is it different from profitability?
3) Distinguish between labour intensity and labour productivity; capital intensity and productivity of capital.
4) Explain why it is necessary for an international organisation to have both, an on- going Monitoring System and ad hoc Performance Evaluation exercises.
5) Do you need a separate MIS for performance evaluation? How far can the two be integrated?
6) What is a standard firm? Why is it the bench mark of performance?
7) Explain how productivity is a preferable performance Evaluation coefficient?
8) What is partial productivity? How does it differ from total productivity?
9) Enumerate six performance evaluation indicators, and define their basic concepts and limitations.
10) How is comparative performance evaluation made? Enumerate the steps.
11) What is ratio analysis? Name four important ratios.
12) What are the value-based project monitoring techniques? Apply this technique to the following project case, and evaluate it in terms of the value-based project monitoring system:

At audit station 2

Targeted civil works	4000 m^2
Budgeted cost	Rs 2600/m^2
Construction completed equivalent of	3900
Cost incurred	Rs 10.8 million
Additional work to cost	Rs 0.4 million

13) Enumerate four causes, which cause cost and time overrun in projects.
14) Explain how project performance differs from the operating performance.
15) Define (i) performance-audit stations (ii) cost over-runs and time over-runs (iii) budget and actual costs.
16) What do you understand by Performance Budget?
17) How does a budget help in performance evaluation? Illustrate it by a *hypothetical* example.
18) Describe the role of PERT and MIS in performance appraisal.
19) Who is the performance evaluator?
20) What is the role of the data collector in the performance evaluation system?

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LESSON – 7
HUMAN RESOURCE MANAGEMENT IN MNC

OBJECTIVES

- To Discuss the characteristics and nature of international HRM
- To Describe the factors affecting IHRM, its functions and staffing policies

STRUCTURE

7.1 Introduction
7.2 Basics of international HRM
7.3 Characteristics of IHRM
7.4 Nature of IHRM
7.5 Factors Affecting IHRM
7.6 HRM Functions
7.7 Strategic Functions of IHRM
7.8 Staffing Policies (Recruitment and Selection)
7.9 Types of Staffing Policy
7.10 Dependence on Expatriate Managers
7.11 Summary
7.12 Keywords
7.13 Self Assessment Questions
7.14 Suggested Readings

7.1 INTRODUCTION

In international business, the big challenge is putting the right person into the right job, in the right place at the right time for the right salary. This challenge is met by the international human resource management. HRM has an important strategic component for international business which reduces costs and adds value to the customers. The need to have highly qualified people to staff the organization cannot be over emphasized. In this unit, factors affecting International Human Resource Management (IHRM), nature and structure of IHRM and staffing policy are discussed.

7.2 BASICS OF INTERNATIONAL HRM

International Human Resource Management (IHRM) is much broader in nature and scope in comparison to HRM. According to John D. Daniels, "IHRM refers to the range of activities that a global company takes to staff its organization—determining its human resource needs, hire people to meet these needs, motivate them to perform well, upgrade their skills so to perform more challenging tasks and finally retaining them".

In the words of Cynthia D. Fisher, “The process of procuring, allocating and effectively utilizing human resource in an international business is called international human resource management”.

International HRM, thus, involves ascertaining the corporate strategy of the company and assessing the corresponding recruitment, staffing and organizational strategy.

7.3 CHARACTERISTICS OF IHRM

The major characteristics of IHRM are as follows:

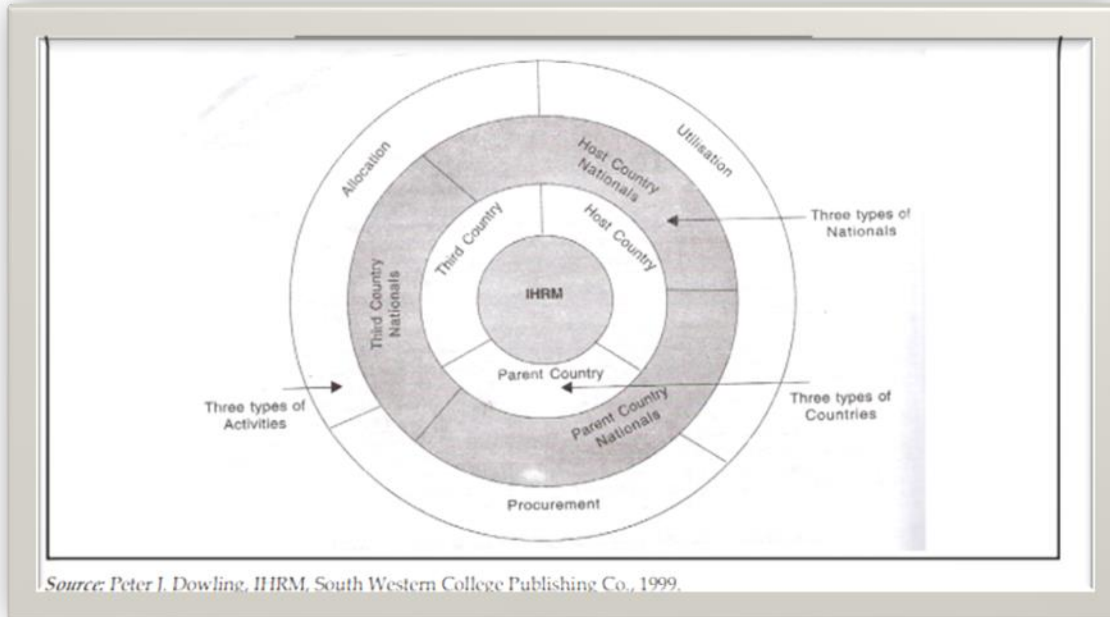
1) Ascertaining the corporate strategy of the company and assessing the corresponding human resource needs.
2) Involves determining the recruitment, staffing and organizational strategy at international level.
3) It involves induction, training and motivating the personnel to perform well.
4) It involves upgrading the skills of the personnel so that they may perform more challenging
5) tasks at international level.
6) The strategic role of HRM is more complex in an international business than that in domestic business.

7.4 NATURE OF IHRM

IHRM involves the interplay among the three dimensions:

1. Human Resource Activities
2. Types of Employees
3. Countries of Operations

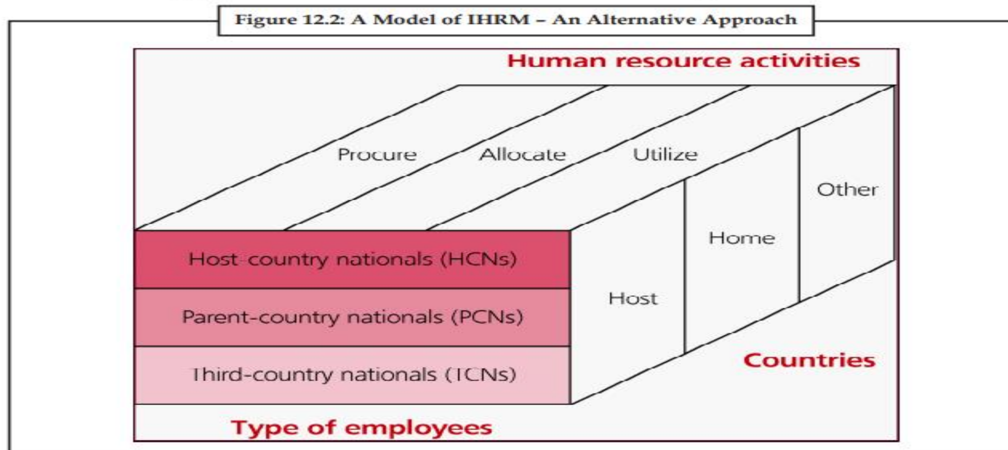
These dimensions reveal the nature of IHRM. It is also explained in the figure 7.1.



Source: Peter J. Dowling, IHRM, South Western College Publishing Co., 1999.

1. **Three Types of Activities:**

The three broad activities of IHRM, namely, procurement, allocating, and utilizing, cover all the six activities of domestic human resources management (HRM). The six functions of domestic HRM are: human resource planning, employee hiring, training and development, remuneration, performance management, and industrial relations. These six functions can be dovetailed with the three broad activities of IHRM. 2. Three Types of Countries: The three national or country categories involved in IHRM activities are: the host-country where a subsidiary may be located, the home-country where the company is headquartered and 'other' countries that may be the source of labour or finance. 3. Three Types of Employees: The three types of employees of an international business include host-country nationals, parent-country nationals, and third-country nationals. Thus, for example, IBM employs Australian citizens in its Australian operations, often sends US citizens to Asia-Pacific countries on assignment, and may send some of its Singaporean employees of an assignment to its Japanese operations



Host Country National (HCN): Belongs to the Country where the subsidiary is located
Parent Country National (PCN): Belongs to the Country where the firm has its Headquarters

Third Country Nationals (TCN): Belongs to any other country and is employed by the firm

7.5 FACTORS AFFECTING IHRM

According to Charles W.L. Hill, "The strategic role of HRM is complex enough in a purely domestic firm, but it is more complex in an international business, where staffing management development, performance evaluation and compensation activities are complicated by profound differences in labour markets, culture, legal system, economic systems and the like".

The following are some of the important factors which make international HRM complex and challenging.

1. Differences in Labour Market Characteristics

The skill levels, the demand and supply conditions and the behaviour characteristics of labour vary widely between countries. While some countries experience human resource shortage in certain sectors, many countries have abundance. In the past, developing countries were regarded, generally, as pools of unskilled labour. Today, however, many developing countries have abundance of skilled and scientific manpower as well as unskilled and semiskilled labour. This changing trend is causing significant shift of location of business activities. Hard disk drive manufacturers are reported to be shifting their production from Singapore to cheaper locations like Malaysia, Thailand and China. While in the past unskilled and semiskilled labour-intensive activities tended to be located in the developing countries, today sophisticated activities also find favour with developing countries. The changing quality attributes of human resources in the developing countries and differentials are causing a locational shift in business activities, resulting in new trends in global supply chain management. India is emerging as a global R&D hub. India and several other developing countries are having large sources of IT personnel. In

short, changing labour market characteristics have been causing global restructuring of business processes and industries. And this poses a great challenge for strategic HRM.

2. Cultural Differences: Cultural differences cause a great challenge to HRM

The behavioural attitude of workers, the social environment, values, beliefs, outlooks, etc. are important factors, which affect industrial relations, loyalty, productivity, etc. There are also significant differences in aspects related to labour mobility. Cultural factors are very relevant in interpersonal behaviour. In some countries it is common to address the boss Mr. so and so but in countries like India addressing the boss by name is not welcomed. In countries like India, people assign a great value to designations and hierarchical levels. This makes delayering and organizational restructuring difficult.

3. Differences in Regulatory Environment

A firm operating in different countries is confronted with different environments with respect to government policies and regulations regarding labour.

4. Attitude towards Employment

The attitude of employers and employees towards employment of people show variations among different nations. In some countries, hire and fire is the common thing whereas in a number of countries the ideal norm has been lifetime employment. In countries like India, workers generally felt that while they have the right to change organisations as they preferred, they had a right to lifetime employment in the organization they were employed with. In such situations, it is very difficult to get rid of inefficient or surplus manpower. The situation, however, is changing in many countries, including India.

5. Difference in Conditions of Employment

Besides the tenancy of employment, there are several conditions of employment the differences of which cause significant challenge to international HRM. The system of rewards, promotion, incentives and motivation, system of labour welfare and social security, etc. vary significantly between countries

7.6 HRM FUNCTIONS

The main functions of HRM are as follows:
Planning for Organizations, Jobs and People
The Strategic Management of Human Resources
Human Resource Planning

Acquiring Human Resources
Selection
Recruitment
Integration

Building and Motivating Performance
HR Development
Performance Appraisal
Compensation Systems

Maintaining Human Resources
Benefits
Safety & Health
Collective Bargaining
Organizational Exit
Employment transitions

Multinational Human Resource Management

7.7 STRATEGIC FUNCTIONS OF IHRM

Research confirms and anecdotes suggest a powerful relationship between HRM process, management productivity and strategic performance. The following figure shows the strategic decisions and their implications for human resource management. CEO and Chairman of General Electric once said, “Success is truly about people, not about where the buildings are. You have got to develop people so they are prepared for leadership jobs and then promote them. That is the most effective way to become more global”.

The Chairman of Unilever in 1990 said, “The single most important issue for us has been and will continue to be, organization and people”.

Research confirms these views, showing that superior human resources can sustain high productivity, competitive advantage and value creation for an international company.

1. High Productivity

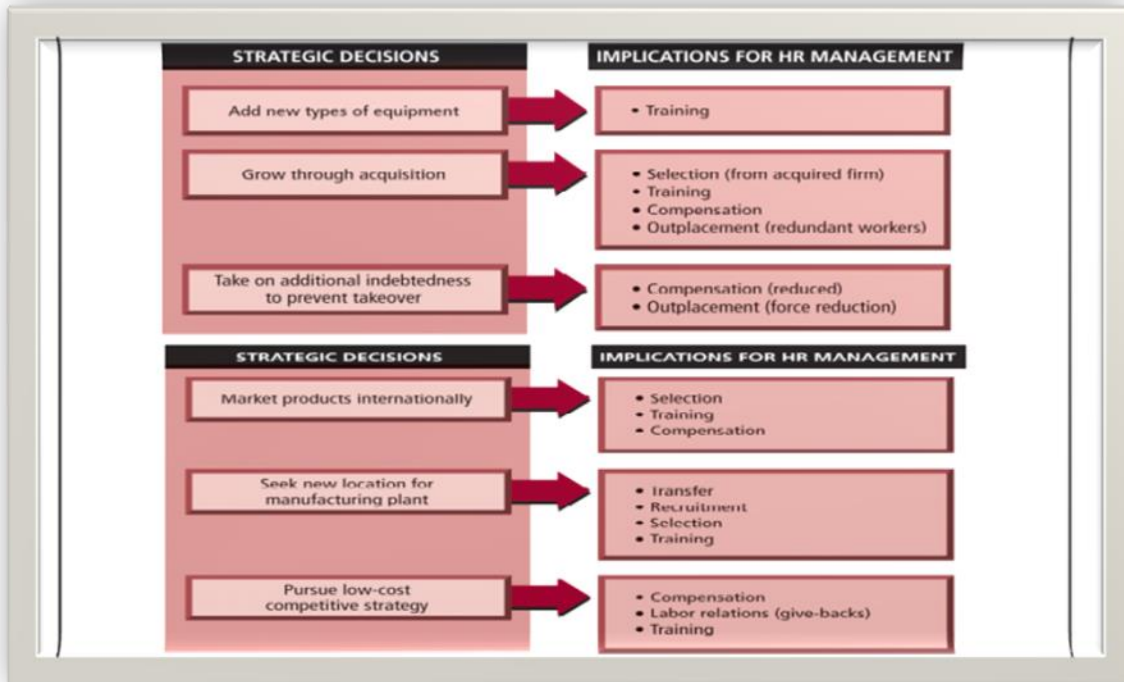
On the basis of the Human Capital Index study, it was found that superior HR practices are positively correlated with the firm’s financial returns. Hence, superior HRM was a stronger determinant of a firm’s financial performance. Research shows that while executives acknowledge that the effectiveness of HR practices materially affects a firm’s performance, many firms fail to achieve their HRM goals.

2. Competitive Advantage

A study of the role of HRM to enhance competitiveness at more than 300 multinationals reported that effectively developing HRM has positive effect on competitive advantage as through better HRM practices the right persons are placed in the right jobs in the right place at the right time for right salary. GE, in 1990s, globalizes its intellect seeking learning and transferring ideas throughout its global operations. This is transnational strategy which has been successful due to application of reused HRM philosophy.

3. Value creation for International Company

The Human Capital Index, based upon a comprehensive global study of over 2000 companies found that superior human resource practices were a leading indicator of increased shareholder value. This implies that superior IHRM system enhances the value for the international company



7.8 STAFFING POLICIES (RECRUITMENT AND SELECTION)

Staffing policy is concerned with the selection of employees for particular jobs. At one level, this involves selecting individuals who have the skills required to do particular jobs. At another level, staffing policy can be a tool for developing and promoting the desired corporate culture of the firm. By corporate culture, we mean the organization's norms and value systems. A strong corporate culture can help a firm to implement its strategy. General Electric, for example, is not just concerned with hiring people who have the skills required for performing particular jobs; it wants to hire individuals whose behavioral styles, beliefs, and value systems are consistent with those of GE. This is true whether an American is being hired, an Italian, a German, or an Australian and whether the hiring is for a US operation or a foreign operation. The belief is that if employees are predisposed toward the organization's norms and value systems by their personality type, the firm will be able to attain higher performance.

7.9 TYPES OF STAFFING POLICY

Research identifies three types of staffing policies in international businesses: the ethnocentric approach, the polycentric approach, and the geocentric approach. We will review each policy and link it to the strategy pursued by a firm. The most attractive staffing policy is probably the geocentric approach, although there are several impediments to adopting it.

1. The Ethnocentric Approach

An ethnocentric staffing policy is one in which all key management positions are filled by parent-country nationals. This practice was very widespread at one time. Firms such as Procter & Gamble, Philips NV, and Matsushita originally followed it. In the Dutch firm Philips, for example, all important positions in most foreign subsidiaries were at one time held by Dutch nationals who were referred to by their non-Dutch colleagues as the Dutch Mafia. In many Japanese and South Korean firms, such as, Toyota, Matsushita, and Samsung; key positions in international operations have often been held by home-country nationals. According to the Japanese Overseas Enterprise Association, in 1996, only 29 percent of foreign subsidiaries of Japanese companies had presidents who were not Japanese. In contrast, 66 percent of the Japanese subsidiaries of foreign companies had Japanese presidents. A firm pursues an ethnocentric staffing policy for three reasons:

(i) The firm may believe that the host country lacks qualified individuals to fill senior management positions. This argument is heard most often when the firm has operations in less developed countries.

(ii) The firm may see an ethnocentric staffing policy as the best way to maintain a unified corporate culture. Many Japanese firms, for example, prefer their foreign operations to be headed by expatriate Japanese managers because these managers have been socialized into the firm's culture while employed in Japan. Procter & Gamble until recently preferred to staff important management positions in its foreign subsidiaries with US nationals who had been socialized into P&G's corporate culture by years of employment in its US operations. Such reasoning tends to predominate when a firm places a high value on its corporate culture.

(iii) If the firm is trying to create value by transferring core competencies to a foreign operation, it may believe that the best way to do this is to transfer parent-country nationals who have knowledge of that competency to the foreign operation. Imagine what might occur if a firm tried to transfer a core competency in marketing to a foreign subsidiary without supporting the transfer with a corresponding transfer of home-country marketing management personnel. The transfer would probably fail to produce the anticipated benefits because the knowledge underlying a core competency cannot easily be articulated and written down. Such knowledge is acquired through experience. Just like the great tennis player who cannot instruct others how to become great tennis players simply by writing a handbook, the firm that has a core competency in marketing-or anything else-cannot just write a handbook that tells a foreign subsidiary how to build the firm's core competency anew in a foreign setting. It must also transfer management personnel to the foreign operation to show foreign managers how to become good marketers. The need to transfer managers overseas arises because the knowledge that underlies the firm's core competency resides in the heads of its domestic managers and was acquired through years of experience and not by reading a handbook. Thus, if a firm is to transfer a core competency to a foreign subsidiary, it must also transfer the appropriate managers. Despite this rationale for pursuing an ethnocentric staffing policy, the policy is now declining in most international businesses for two reasons. First, an

ethnocentric staffing policy limits advancement opportunities for host-country nationals. This can lead to resentment, lower productivity, and increased turnover among that group. Resentment can be greater still if, as often occurs, expatriate managers are paid significantly more than host-country nationals.

Second, an ethnocentric policy can lead to “cultural myopia,” the firm’s failure to understand host country’s cultural differences that require different approaches to marketing and management. The adaptation of expatriate managers can take a long time, during which they may make major mistakes. For example, expatriate managers may fail to appreciate how product attributes, distribution strategy, communications strategy, and pricing strategy should be adapted to host-country conditions. The result may be costly blunders. They may also make decisions that are ethically suspected simply because they do not understand the culture in which they are managing. In one highly publicized case in the United States, Mitsubishi Motors was sued by the Federal Equal Employment Opportunity Commission for tolerating extensive and systematic sexual harassment in a plant in Illinois. The plant’s top management, all Japanese expatriates, denied the charges.

The Japanese managers may have failed to realize that the behaviour that would be viewed as acceptable in Japan was not acceptable in the United States. Did u know? It is still a widespread practice in MNCs, to fill key positions with home country nationals.

2. The Polycentric Approach

A polycentric staffing policy recruits host-country nationals to manage subsidiaries while parent-country nationals occupy key positions at corporate headquarters. In many respects, a polycentric approach is a response to the shortcomings of an ethnocentric approach. One advantage of adopting a polycentric approach is that the firm is less likely to suffer from cultural myopia. Host-country managers are unlikely to make the mistakes arising from cultural misunderstandings to which expatriate managers are vulnerable. A second advantage is that a polycentric approach may be less expensive to implement, reducing the costs of value creation. Expatriate managers can be very expensive to maintain.

A polycentric approach also has its drawbacks. Host-country nationals have limited opportunities to gain experience outside their own country and thus cannot progress beyond senior positions in their own subsidiary. As in the case of an ethnocentric policy, this may cause resentment. Perhaps the major drawback with a polycentric approach, however, is the gap that can form between host-country managers and parent-country managers.

Language barriers, national loyalties, and a range of cultural differences may isolate the corporate headquarters staff from the various foreign subsidiaries. The lack of management transfers from home to host countries, and vice versa, can exacerbate this isolation and lead to a lack of integration between corporate headquarters and foreign subsidiaries. The result can be a “federation” of largely independent national units with only nominal links to the corporate headquarters. Within such federation, the coordination required to transfer core competencies or to pursue experience curve and location economies may be difficult to achieve. Thus, although a

polycentric approach may be effective for firms pursuing a localization strategy, it is inappropriate for other strategies.

The federation that may result from a polycentric approach can also be a force for inertia within the firm. After decades of following a polycentric staffing policy, food and detergents giant Unilever found that shifting from a strategic posture that emphasized localization to a transnational posture was very difficult. Unilever's foreign subsidiaries had evolved into quasi-autonomous operations, each with its own strong national identity. These 'little kingdoms' objected strenuously to corporate headquarters' attempts to limit their autonomy and to rationalize global manufacturing.

3. The Geocentric Approach

A geocentric staffing policy seeks the best people for key jobs throughout the organization, regardless of nationality. This policy has a number of advantages. First, it enables the firm to make the best use of its human resources. Second, and perhaps more important, a geocentric policy enables the firm to build a cadre of international executives who feel at home working in a number of cultures. Creation of such a cadre may be a critical first step toward building a strong unifying corporate culture and an informal management network, both of which are required for global standardization and transnational strategies. Firms pursuing a geocentric staffing policy may be better able to create value from the pursuit of experience curve and location economies and from the multidirectional transfer of core competencies than firms pursuing other staffing policies. In addition, the multinational composition of the management team that results from geocentric staffing tends to reduce cultural myopia and to enhance local responsiveness. Thus, other things being equal, a geocentric staffing policy seems the most attractive.

A number of problems limit the firm's ability to pursue a geocentric policy. Many countries want foreign subsidiaries to employ their citizens. To achieve this goal, they use immigration laws to require the employment of host-country nationals if they are available in adequate numbers and have the necessary skills. Most countries (including the United States) require firms to provide extensive documentation if they wish to hire a foreign national instead of a local national. This documentation can be time consuming, expensive, and at times futile. A geocentric staffing policy also can be very expensive to implement. Training and relocation costs increase when transferring managers from country to country. The company may also need a compensation structure with a standardized international base pay level higher than national levels in many countries. In addition, the higher pay enjoyed by managers placed on an international 'fast track' may be a source of resentment within a firm.

Comparison of Staffing Approaches

The advantages and disadvantages of the three approaches to staffing policy are summarized in Table 3.1. Broadly speaking, an ethnocentric approach is compatible with an international strategy, a polycentric approach is compatible with a localization strategy, and a geocentric approach is compatible with both global standardization and transnational strategies.

Staffing Approach	Strategic Appropriateness	Advantages	Disadvantages
Ethnocentric	International	• Overcomes lack of qualified managers in host nation; • Unified culture; • Helps transfer core competencies	• Produces resentment in host country; • Can lead to cultural myopia
Polycentric	Localization	• Alleviates cultural myopia • Inexpensive to implement	• Limits career mobility; • Isolates headquarters from foreign subsidiaries
Geocentric	Global Standardization and Transnational	• Uses human resources efficiently; • Helps build strong culture and informal management networks	• National immigration policies may limit implementation; • Expensive

Example: Electrolux for many years has attempted to recruit and develop a group of international managers from different countries to constitute a mobile base of managers

While the staffing policies described here are well known among both practitioners and scholars of international businesses, some critics have claimed that the typology is too simplistic and that it obscures the internal differentiation of management practices within international businesses. The critics claim that within some international businesses, staffing policies vary significantly from national subsidiary to national subsidiary; while some are managed on an ethnocentric basis, others are managed in a polycentric or geocentric manner. Other critics note that the staffing policy adopted by a firm is primarily driven by its geographic scope, as opposed to its strategic orientation. Firms that have a very broad geographic scope are the most likely to have a geocentric mind-set.

7.10 DEPENDENCE ON EXPATRIATE MANAGERS

Two of the three staffing policies we have discussed – the ethnocentric and the geocentric – rely on extensive use of expatriate managers. Expatriates are citizens of one country who are working in another country. Sometimes the term expatriates is used to identify a subset of expatriates who are citizens of a foreign country working in the home country of their multinational employer. Thus, a citizen of Japan who moves to the United States to work at Microsoft would be classified as an expatriate. With an ethnocentric policy, the expatriates are all home-country nationals who are transferred abroad. With a geocentric approach, the expatriates need not be homecountry nationals; the firm does not base transfer decisions on nationality. A prominent issue in the international staffing literature is expatriate failure—the premature return of an expatriate manager to his or her home country. Research suggests that between 16 and 40 percent of all American employees, sent abroad to developed nations, return from their assignments early, and almost 70 percent of employees sent to developing nations return home early. According to the Study of US, European and Japanese multinationals prepared by R.L.

Tung for US multinationals, the reasons for higher expatriate failure, in order of importance, were

According to the Study of US, European and Japanese multinationals prepared by R.L. Tung for US multinationals, the reasons for higher expatriate failure, in order of importance, were How to Reduce Expatriate Failure Rates? Expatriate Selection One way to reduce expatriate failure rates is by improving selection procedures to screen out inappropriate candidates. In a review of the research on this issue, Mendenhall and Oddou state that a major problem in many firms is that HRM managers tend to equate domestic performance with overseas performance potential. Domestic performance and overseas performance potential is not the same thing. An executive who performs well in a domestic setting may not be able to adapt to managing in a different cultural setting. From their review of the research, Mendenhall and Oddou identified four dimensions that seem to predict success in a foreign posting: self-orientations, others-orientation, perceptual ability and cultural toughness.

1. **Self-orientation:** The attributes of this dimension strengthen the expatriate's self-esteem, self-confidence, and mental well-being. Expatriates with high self-esteem, self-confidence, and mental well-being were more likely to succeed in foreign postings. Mendenhall and Oddou concluded that such individuals were able to adapt their interests in food, sport, and music; had interests outside of work that could be pursued (e.g., hobbies); and were technically competent.

2. **Others' Orientation:** The attributes of this dimension enhance the expatriate's ability to interact effectively with host-country nationals. The more effectively the expatriate interacts with the host country nationals, the more likely he or she is to succeed. Two factors, particularly, seem to be important here: relationship development and willingness to communicate. Relationship development refers to the ability to develop long-lasting friendships with host-country nationals. Willingness to communicate refers to the expatriate's willingness to use the host-country language. Although, language fluency helps, an expatriate need not be fluent to show willingness to communicate. Making the effort to use the language is more important. Such gestures tend to be rewarded with greater cooperation by host-country nationals.

3. **Perceptual ability**: This is the ability to understand why people of other countries behave the way they do; that is, the ability to empathize. This dimension seems critical for managing host-country nationals. Expatriate managers who lack this ability tend to treat foreign nationals as if they were home-country nationals. As a result, they may experience significant management problems and considerable frustration. As an expatriate executive from Hewlett-Packard observed, "It took me six months to accept the fact that my staff meetings would start 30 minutes late, and that it would bother no one but me." According to Mendenhall and Oddou, well-adjusted expatriates tend to be non-judgmental and non-evaluative in interpreting the behavior of the host country nationals and willing to be flexible in their management style, adjusting it as cultural conditions warrant. 4. Cultural toughness: This dimension refers to the relationship between the country of assignment and how well an expatriate adjusts to a particular posting. Some countries are considered as tougher postings than others because their

cultures are more unfamiliar and uncomfortable. For example, many Americans regard Great Britain as a relatively easy foreign posting, and for good reason the two cultures have much in common. But many Americans find postings in non-Western cultures, such as India, Southeast Asia, and the Middle East, to be much tougher. The reasons are many, including poor health care and housing standards, inhospitable climate, lack of Western entertainment, and language difficulties. Also, many cultures are extremely male-dominated and are considered as particularly difficult postings for female managers.

3.11 SUMMARY

- International human resource management (IHRM) is much broader in nature and scope in comparison to HRM.
- International HRM, thus, involves ascertaining the corporate strategy of the company and assessing the corresponding recruitment, staffing and organizational strategy.
- There are various characteristics of international HRM
- IHRM involves the interplay among the three dimensions, namely IHRM involves the interplay among the three dimensions namely, human resource activities, types of employees and countries of operations.
- There are some important factors which make international HRM complex and challenging.
- Research confirms and anecdotes suggest a powerful relationship between HRM process, management productivity and strategic performance. There are certain strategic decisions and their implications for human resource management.
- Staffing policy is concerned with the selection of employees for particular jobs.
- Two of the three staffing policies we have discussed – the ethnocentric and the geocentric – rely on extensive use of expatriate managers

3.12 KEYWORDS

Bearer Bond: A bearer bond possession is evidence of ownership. The issue does not keep any records indicating who the current owner of a bond is.
Ethnocentric staffing policy: It is one in which all key management positions are filled by parentcountry nationals.
Eurocurrency: Eurocurrency is the time deposit of money in an international bank located in a country different from the country that issued the currency.
Geocentric Staffing Policy: It seeks the best people for key jobs throughout the organization, regardless of nationality. This policy has a number of advantages.
Polycentric Staffing Policy: It recruits host-country nationals to manage subsidiaries while parent-country nationals occupy key positions at corporate headquarters.
Registered Bond: With registered bonds, the owner's name is on the bond and it is also recorded by the issuer.
Staffing Policy: It is concerned with the selection of employees for particular jobs

3.13 SELF ASSESSMENT QUESTIONS

1. What is international human resource management?
2. Discuss the main characteristics and nature of IHRM.
3. What are the factors affecting international human resource management?
4. Discuss the strategic functions of IHRM.
5. Discuss the different approaches to international staffing policy.
6. What are the important determinants of international staffing policy?
7. Compare and contrast between the different staffing approaches.

3.14 SUGGESTED READINGS

1) Justin Paul, International Business, (3rd ed.), Prentice Hall of India.
2) Charles W L Hill, Arun K Jain, International Business, 2009, Tata McGraw Hill, New Delhi.
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Dr. V.NAGA NIRMALA

LESSON -8

INTERNATIONAL PRODUCTION AND LOGISTICS MANAGEMENT

OBJECTIVES

- ✓ To Discuss the international production management
- ✓ To Learn the concept of international logistic management
- ✓ To discuss the Strategic Role of Foreign Factories
- ✓ To Study Similarities between Domestic and Global Supply Chain Management

STRUCTURE

8.1 Introduction
8.2 International Production and Logistics Management
8.3 Where to Manufacture
8.4 Country Factors
8.5 Product Factors
8.6 Strategic Role of Foreign Factories
8.7 Role of Information Technology and the Internet
8.8 International Logistics Management
8.9 Components of International Logistics
8.10 Similarities between Domestic and Global Supply Chain Management
8.11 Information Technology and International Logistics
8.12 Summary
8.13 Keywords
8.14 Self Assessment Questions
8.15 Suggested Readings

8.1 INTRODUCTION

Our focus now shifts from the environment to the firm itself and in particular to the actions managers take to compete more effectively as an international business. We discuss how firms can increase their profitability by expanding their operations in foreign markets. We discuss different strategies that firms pursue when competing internationally, pros and cons of these strategies, the various factors that affect firms' choice of strategy and what practice firms adopt across various national markets.

As trade barriers fall and global markets develop many firms face a set of interrelated issues:

1. Where the production facilities should be located, should it be concentrated in a single country or should they be dispersed around the globe, matching the type of activity with country differences in factor costs, tariff barriers, political risk and the like in order to minimize costs and maximize value added.

2. What should be the long-term strategic role of foreign production sites? Should the firm abandon a foreign site if factor costs change, moving production to another favourable location or is there value to maintain an operation at a given location even if underlying economic conditions change?

3. Should the firm own production facilities, or it is better to outsource them to independent vendors?

4. How should a globally dispersed supply change be managed and what is the role of Internet-based information technology in the management of global logistics?

5. Should the firm manage global logistics itself, or should it outsource the management to enterprises that specialize in this activity?

8.2 INTERNATIONAL PRODUCTION AND LOGISTICS MANAGEMENT

In this unit attempt has been made how these two functions be performed internationally to

(1) lower the costs of value creation and
(2) add value by better serving customer needs. It is also necessary to discuss the contribution made by information technology to these activities, which has become important in the era of internet.

Production may be defined as "the activities involved in creating a product". The term production denotes both service and manufacturing activities, since one can produce a service or produce a physical product. Production can be replaced with manufacturing. Materials management is the activity that controls the transmission of physical materials through the value chain, from procurement through production and into distribution. Materials management includes logistics, which refers to the procurement and physical transmission of material through supply chain, from suppliers to customers. Manufacturing and Materials management are closely linked, since a firms ability to perform its manufacturing function efficiently depends on a continuous supply of high-quality material inputs, for which materials management is responsible.

The manufacturing and materials management functions of an international firm have a number of important strategic objectives:

One is to lower costs. Dispersing manufacturing activities to various locations around the globe where each activity can be performed most efficiently can lower costs. Costs can be lowered by managing the global supply chain efficiently so as to better match supply with demand Efficient supply chain management reduces the amount of inventory in the nsystem and increases inventory turnover, which means the firm has to invest less working capital in inventory and is less likely to find excess inventory on hand that cannot be sold and has to be written off.

Second strategic objective shared by manufacturing and materials management is to increase product quality by eliminating defective products from both the supply chain and the manufacturing process. The objective of reducing costs and increasing quality are not independent of each other. The firm that improves its quality control will also reduce its costs of value creation. Improved quality control reduces cost in three ways:

Increases productivity because time is not wasted manufacturing poor-quality products that cannot be sold, leading to a direct reduction in unit costs.

Lowers rework and scrap costs.
Lowers warranty costs.

Identifying the Target Audience:

Even for the same product the target audience may be different in different countries. For example, bicycles are basic means of transportation in countries like India and the important category of consumers are small farmers, blue-collar workers and students. In some of the advanced countries, bicycles are used for sporting and exercising and hence the target audience is different.

1. The effect is to lower the costs of value creation by reducing both manufacturing and service costs.

2. The main management technique that companies are utilizing to boost their Product quality is Total Quality Management (TQM).

3. The growth of international standards has also focused greater attention on the importance of product quality.

4. In addition to the objectives of lowering costs and improving quality, two other objectives have particular importance in international business:

First, manufacturing and materials management must be able to accommodate demands for local responsiveness.

Second, manufacturing and materials management must be able to respond quickly to shifts in customer demand. In recent years time based competition has grown more important. When consumer demand is prone to large and unpredictable shifts, the firm that can adapt most quickly to these shifts will gain an advantage.

8.3 WHERE TO MANUFACTURE

An essential decision facing an international firm is where to locate its manufacturing activities to achieve the goals of maintaining costs and improving product quality. For the form contemplating international production, a number of factors must be considered which can be grouped under three broad headings: Country factors, technological factors and product factors.

8.4 COUNTRY FACTORS

The following needs to be focused:

1. Difference in political economy and national culture influence the benefits, costs and risks of doing business in a country. A firm should locate its various manufacturing activities where the economic, political and cultural conditions.
2. Differences in factor costs, certain countries have a comparative advantage for producing certain products.
3. Role of location externalities in influencing foreign direct investment decisions. Externalities include the presence of an appropriately skilled labour pool and supporting industries.

For example, because of cluster of semiconductor manufacturing plants in Taiwan, a pool of labour with experience in the semiconductor business has developed. In additions the plants have attracted a number of supporting industries, such as the manufacturer of semiconductor equipment and silicon, which have been established facilities in Taiwan to be near their customers.

Formal and informal trade barriers influence location decision.
Rules and regulations regarding direct foreign investment.

Expected future movements in its exchange rate. Adverse changes in exchange rates can quickly alter a country's attractiveness as a manufacturing base. Example, many Japanese corporations had to grapple with this problem during the 1990s.

Product's value to weight ration because of its influence on transportation costs.

Technological Factors

Here we are concerned with manufacturing technology, the technology that performs specific manufacturing activities. Three characteristics of manufacturing technology are of interest here– the level of fixed costs, the minimum efficient scale and the flexibility of technology:

Level of Fixed Costs

In some cases the fixed costs of setting up a manufacturing plant is so high that firm must serve the world market from a single location or from a very few locations. For example, it costs more than $ 1 billion to set up a state-of-the-art plant to manufacture semiconductor chips. Hence serving the world market from one single location makes sense.

Minimum Efficient Scale

The concept of economies of scale tells us that as plant output expands, unit costs decrease. The reasons include the greater utilization of capital equipment and productivity gains that come with specialization of employees within the plant. However, beyond a certain level of

output, few additional scale economies are available. Thus the unit cost curve declines with output until a certain output level is reached, at which point further increases in output realize little reduction in input costs.

Flexible Manufacturing and Mass Customization

Central to the concept of economies of scale is the idea that the best way to achieve high efficiency, and hence low unit costs, is through the mass production of a standard output. The trade-off implicit in this idea is between unit costs and product variety. Producing greater product variety from a factory implies shorter production runs, which in turn implies an inability to realize economies of scale.

This view of production efficiency has been challenged by the rise of flexible manufacturing technologies. The term flexible manufacturing technology-or lean production-covers a range of manufacturing technologies designed to

(1) reduce setup times for complex equipment

(2) increase the utilization of individual machines through better scheduling and

(3) improve quality control at all stages of the manufacturing process. Flexible manufacturing technologies may actually allow the company to produce a wide variety of end products at a unit cost that at one time could only be achieved through the mass production of a standardized product, while at the same time enabling the company to customize its product offering to a much greater extent than was once thought possible. The term mass customization has been coined to describe the ability of companies to use flexible manufacturing plants have attracted a number of supporting industries, such as the manufacturer of semiconductor equipment and silicon, which have been established facilities in Taiwan to be near their customers.

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2. Expected future movements in its exchange rate. Adverse changes in exchange rates can quickly alter a country's attractiveness as a manufacturing base. Example, many Japanese corporations had to grapple with this problem during the 1990s.
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8.5 PRODUCT FACTORS

First is the product's value-to-weight ratio because of its influence on transportation costs. Many electronic components and pharmaceuticals have high value-to-weight ratios, they are expensive and they do not weigh very much. Thus, even if they are shipped halfway around the world, their transportation costs account for a very small percentage of total costs. Given this, other things being equal, there is great pressure to manufacture these products in the optimal location and to serve the world market from there. The opposite hold for products with low value to weight ratios refined sugar, certain bulk chemicals, paint and petroleum products all have low value-to-weight ratios; they are relatively inexpensive products that weigh a lot. Accordingly, when they are shipped long distances, transportation costs account for a large percentage of total costs. Thus other things being equal, there is great pressure to manufacture these products in multiple locations close to major markets to reduce transportation costs.

The other product feature that can influence location decisions is whether the product serves universal needs, needs that are the same all over the world. Examples include many industrial products e.g. industrial electronics, steel, bulk chemicals and modern consumer products

e.g. handheld calculators and personal computers. Since there are few national differences in consumer taste and preference for such products, the need for local responsiveness is reduced.

Locating Manufacturing Facilities

There are two basic strategies for locating manufacturing facilities concentrating them in a centralized location and serving the world market from there, or decentralize them in various regional or national locations that are close to major markets. The appropriate strategic choice is determined by the various country, technological, and product factors and is summarized in the following table:

Table 14.1: Location Strategy and Manufacturing

Factors	Concentrated Manufacturing Favoured	Decentralized Manufacturing Favoured
Country Factors		
Differences in political economy	Substantial	Few
Differences in culture	Substantial	Few
Differences in factor costs	Substantial	Few
Trade barriers	Substantial	Few
Location externalities	Important in industry	Not important in industry
Exchange rates	Stable	Volatile
Technological Factors		
Fixed costs	High	Low
Minimum efficient scale	High	Low
Flexible manufacturing technology	Available	Not available
Product factors		
Value-to-weight ratio	High	Low
Serves universal needs	Yes	No

In practice, location decisions are seldom clear-cut. For example, it is not unusual for difference in factor costs, technological factors, and product factors to point toward concentrated manufacturing while a combination of trade barriers and volatile exchange rates points towards decentralized manufacturing. For example, world automobile industry. Although the availability of flexible manufacturing and cars' relatively high value-to-weight ratios suggest concentrated manufacturing, the combination of formal and informal trade barriers and the uncertainties of the world's current floating exchange rate regime have inhibited firms' ability to pursue this strategy. For these reasons, several automobile companies have established 'top-to-bottom' manufacturing operations in three major regional markets: Asia, North America and Western Europe

8.6 STRATEGIC ROLE OF FOREIGN FACTORIES

Rationale behind establishing a foreign manufacturing facility evolves over time. Initially many foreign factories are established where labour costs are low. Their strategic role typically is to produce labour-intensive products at low cost as possible. For example beginning of 1970, many US firms in the computer and telecommunication equipment business established factories across Southeast Asia as Malaysia, Thailand and Singapore since these countries offered an attractive combination of low labour costs, adequate infrastructure and a favourable tax and trade regime. Initially the components produced by these factories were designed elsewhere and the final product would be assembled elsewhere. Overtime, however the strategic role of some factories have expanded, they have become important centres for the design and final assembly of products for the global marketplace. An example is Hewlett-Packard's operation in Singapore.

Such upward migration in the strategic role of foreign factories arises because many foreign factories upgrade their own capabilities. This improvement comes from two sources. First, pressure from the centre to improve a factory's cost structure and/or customize a product to the demands of customers in a particular nation can start a chain of events that ultimately leads to development of additional capabilities at that factory. Second, source of improvement to the capabilities of a foreign factory can be the increasing abundance of advanced factors of production in the nation in which the factory is located. Many nations that were considered economic backwaters a generation ago have been experiencing rapid economic development during the 1980s and 1990s. Their communication and transportation infrastructures and education level of the population have improved. While these countries once lacked the advanced infrastructure required to support sophisticated design, development and manufacturing operations, this is no longer the case

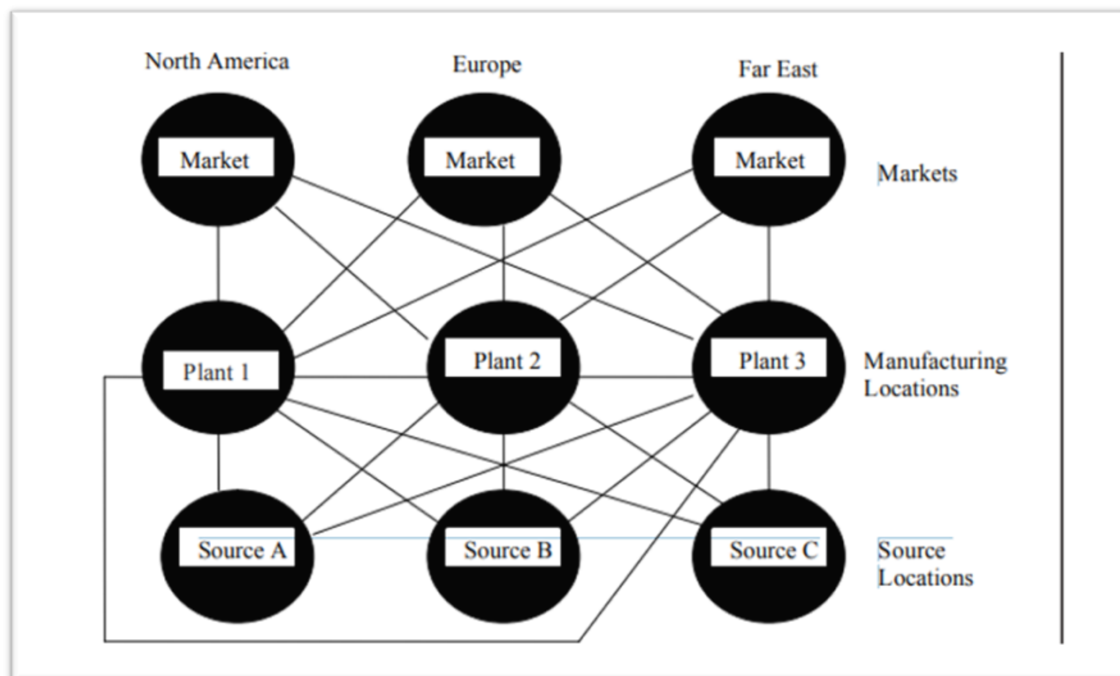

Figure 8.1 shows the linkages that might exist for a firm that sources, manufactures and sells internationally. Each linkage represents a flow of materials, capital, information, decisions and people. The firm must figure out the best organization to achieve tight coordination of the various stages of the value creation process

There are two ways of organising materials management as a business process:

To separate out materials management as a function and give it equal weight in organizational terms, with other more traditional functions such as manufacturing, marketing and R&D.

According to materials management specialists, purchasing, production, and distribution are not separate activities but three aspects one basic task: controlling the flow of materials and products from sources of supply through manufacturing and distribution into the hands of customers.

Despite the apparent cost and quality control advantages of having a separate materials management function, all the firms do not operate with such a function. In such an organization, purchasing, production planning and control, and distribution are not integrated. Planning and control are part of the manufacturing function, while distribution is part of the marketing function. Such companies will be unable to establish materials management as a major strength and consequently may face higher costs.

The next dilemma is determining the best structure in a multinational enterprise. In practice, authority is either centralized or decentralized. Under a centralized solution, most materials management decisions are made at the corporate level, which can ensure efficiency and adherence to overall corporate objectives. This is the case at Dell Computer, for example. In large complex organizations with many manufacturing plants, however a centralized materials management function may become overloaded and unable to perform its task effectively. In such cases a centralized solution is needed.

A decentralized solution delegates most material management decisions to the level of individual manufacturing plants within the firms, although corporate headquarters retains responsibility for overseeing the function. The great advantage of decentralizing is that it allows Plant – level materials management groups to develop the knowledge and skills needed for interacting with foreign suppliers that are important to the respective plant, this can lead to better decision making. The disadvantage is that a lack of co-ordination between plants can result in less than optimal global sourcing. It can also lead to duplication of materials management efforts.

8.7 ROLE OF INFORMATION TECHNOLOGY AND THE INTERNET

Web-based information systems play a crucial role in modern materials management by tracking component parts as they make their way across the globe to word and assembly plant, information systems enable a firm to optimize its production scheduling based on time, components are expected to arrive by locating component parts in the supply change, good

information systems allow the firm to accelerate production when needed by pulling key component out of the regular supply chain and having flown them to the manufacturing plant.

Firms increasingly use electronic data interchange to co-ordinate the flow of materials into manufacturing, through manufacturing and out to customers. EDI systems require computer links between a firm, its suppliers and its shippers. These Electronic links are then used to place orders with suppliers, to register parts, leaving a supplier, to track them as they travel toward a manufacturing plant and to register their arrival. Suppliers use an EDI link to send invoices to the purchasing firm. The major advantage of an EDI system is that supplies, shippers, and the purchasing firm can communicate with each other with no time delay, which increases the flexibility and responsiveness of the whole supply chain. A second advantage is that major paperwork between suppliers, shippers, and the purchasing firm is eliminated Good EDI systems can help affirm decentralize materials management decisions to the plant level by giving corporate-level managers the information they need for coordination and control of the decentralized materials management groups.

Before the emergence of the Internet as a major communication medium, firms and their suppliers were required to buy expensive proprietary software solutions to implement EDI systems. The ubiquity of the Internet and the availability of Web based applications have made most of these There are two ways of organising materials management as a business process:

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Acquisition of Resources

Businesses operating in a foreign market can take advantage of the resources of the area, including natural and human resources. Business managers looking for an ideal location for an international branch should consider factors, such as property, raw materials, population and amenities. Many emerging markets create incentive programs designed to lure and assist foreign business.

Location Decisions

We have seen that countries differ along a range of dimensions, including the economic, political, legal, and cultural, and that these differences can either raise or lower the costs of doing business in a country. The theory of international trade also teaches us that due to differences in factor costs, certain countries have a comparative advantage in the production of certain products. Japan might excel in the production of automobiles and consumer electronics; the United States in the production of computer software, pharmaceuticals, biotechnology products, and financial services; Switzerland in the production of precision instruments and pharmaceuticals; and South Korea in the production of steel.

For a firm that is trying to survive in a competitive global market, it means that, trade barriers and transportation costs permitting, the firm will benefit by basing each value creation activity it performs at that location where economic, political, and cultural conditions, including relative factor costs, are most conducive to the performance of that activity.

Firms that pursue such a strategy can realize what we refer to as location economies, the economies that arise from performing a value creation activity in the optimal location for that activity, wherever in the world that might be transportation costs and trade barriers permitting. Locating a value creation in the optimal location for that activity can have one of the two effects. It can lower the costs of value creation and help the firm to achieve a low cost position, and/or it can enable a firm to differentiate its product offering from the offerings of competitors.

Creating a Global Web

One can think of a creation of a global web of value creation activities, with different stages of he value chain being dispersed to those location around the globe where perceived value is maximized or where the costs of value creation are minimized. Consider the case of General Motors'. Marketed primarily in the United States, the car was designed in Germany; key components were manufactured in Japan, Taiwan and Singapore; assembly was performed in South Korea; and the advertising strategy was formulated in Great Britain. The car was designed in Germany because GM believed the designers in its German subsidiary had the skills most suited to the job at hand. (They were most capable of producing a design that added value.)

Components were manufactured in Japan, Taiwan and Singapore because of favourable factor conditions – relatively low cost, skilled labour – suggested that those locations had a comparative advantage in the production of components (which helped the costs of value creation). The car was assembled in South Korea because GM believed that due to its low labour costs, the costs of assembly could be minimized there (also helping to minimize the costs of value creation).

Finally the advertising strategy was formulated in Great Britain because GM believed a particular advertising strategy there was able to produce an advertising campaign that would help sell the car. (This decision was consistent with GM's desire to maximize the value added.) Did u know? For a firm to survive in global market, it should base itself where factor costs are most conductive to its business.

In theory, a firm that realizes location economies by dispersing each of its value creation activities to its optimal location should have a competitive advantage vis-à-vis a firm that bases all of its value creation activities at a single location. It should be able to better differentiate its product offering thereby raising perceived value, (V) and lower its cost structure (C) than its single location competitor. In a world where competitive pressures are increasing, such a strategy may become an imperative for survival.

If transportation costs and trade barriers are introduced, the situation is somewhat complicated. Due to favourable factor endowments, New Zealand may have a comparative advantage for automobile assembly operations, but high transportation costs would make it an uneconomical location from which to serve global markets. The location of production facilities of a global corporation may be influenced by a number of factors.

Nature of Organization

The organizational model is a major determinant of the location. For example, in a Multinational Company, the subsidiaries do most of the production for their respective markets. In an International Company and Global Company, there is tendency to centralize core production activities in the home country. The transnational corporation is characterised by globally integrated networks of production facilities and other factors.

Cost

Given other factors (like political factors, organizational model and strategic-orientation etc.), the overall cost of operations is often the most important consideration in the location decision-making. Important factors, which determine the cost, include the following:

Scale Economies

Where there are large-scale economies in production, production tends to concentrate in one or very limited number of locations. Such concentration may be in the home country or foreign countries.

Nature of Assembly Operations

If there is large economies of scale in production of components and if the assembly operations are labour intensive, the locations of components manufacture and assembly operations could be different. The assembly operations may be carried out in countries where the labour is very cheap.

Taxes and Transport Costs

The import duty structure also influences the location of production phases. If the import duty is very high on finished product and comparatively low on components it would encourage assembling of the product in the foreign market. If the cost of transporting the finished product is significantly higher than for the components, export in the CKD form would be preferred and the assembling of the product would be done in the foreign market. This will be particularly attractive if the labour is cheap in the foreign market. Sometimes the import duty and transport cost will favour the complete or most of the manufacturing activity in the foreign market.

Exchange Rate Variation

Exchange rate fluctuations may also influence the import vs. manufacturing decision. A depreciation of the foreign currency vis-à-vis the home currency will make imports into the foreign country costly and this may encourage production within the foreign market.

Availability and Cost of Inputs

Availability and cost of inputs (including land and infrastructure), obviously, are critical factors influencing the location decision. The infrastructure and other facilities and incentives are the attraction of export processing/special economic zones.

Factors

Certain locations are preferred because of logistical reasons the cost and ease of moving products to various markets. Some locations (Singapore, for example) are indeed regarded as the hub of international operations.

Government Policies and Regulations

Government regulations like foreign investment policy, environmental regulations, local content stipulations, labour laws, taxation, assistances and incentives, dividend policies, etc., influence the location.

Social and Political Factors

Social and political factors such as attitude towards foreign business, domestic harmony and peace, etc. also influence the location decision.

8.8 INTERNATIONAL LOGISTICS MANAGEMENT

According to John Daniels and Lee H. Radebaugh an important dimension of the supply chain is logistics, also sometimes called materials management. It is the design and management of a system that controls the forward and reverse flow of materials, services, and information into, through, and out of the international corporation.

According to the Council of Logistics Management, USA, "logistics management is the "process of planning, implementing and controlling the efficient, cost effective flow and storage of raw materials, in-process inventory, finished goods, and related information from point of origin to point of consumption for the purpose of conforming to the customer requirements." The difference between supply chain management and materials management is only of degree. Materials management, or logistics, focuses much more on the transport and storage of materials and final goods, whereas supply chain management extends beyond that to include the management of supplier and customer relations.It is an important component of operations management

8.9 COMPONENTS OF INTERNATIONAL LOGISTICS

Logistics encompasses the total movement concept, covering the entire range of operations concerned with the movement of materials and products to, through, and out of the firm to the consumer. It includes a variety of activities such as inventory management, warehousing and storage, transportation, materials handling, order processing, distribution, communications, packaging, salvage and scrap disposal, returned goods handling, customer service, etc.

The various components of logistics are as under:

1. Fixed Facilities Location: The major consideration is the location of fixed facilities like production and warehousing in such a way as to maximize the total efficiency of the logistics system. Factors like future potential of the markets, future plans of the company, competitive factors and political stability are also important considerations.

2. Inventory Management: The main objective of inventory management is to minimize the cost of the inventory while ensuring smooth supplies. Developments in inventory management by the customers' order processing and in the total logistics system have made inventory management both challenging and efficient.

3. Order Processing: The efficiency of order processing by the client as well as the company has important implications for inventory levels and other aspects of the logistics. Rapid order processing shortens the order cycle and allows for lower safety stocks on the part of the client. Exporters from developing countries like India face the challenge of coping up with such situations.

4. Material Handling and Transportation: Material handling and transportation are also an important part of the logistics management. The technologies in use in material handling and transportation affect the efficiency of logistics.

8.10 SIMILARITIES BETWEEN DOMESTIC AND GLOBAL SUPPLY CHAIN MANAGEMENT

Though the concept of supply chain management is same at the domestic and international level, when it comes to practice few similarities and differences are there. The similarities are:
Conceptual framework
Involve the movement and storage of products
Role of information
Quality monitoring
Economic and safety regulations

Differences between Domestic and Global Supply Chain Management
The differences between domestic and global supply chain management are:
Distance
Language
Cultural differences
Currency
Political stability
Infrastructure

8.11 INFORMATION TECHNOLOGY AND INTERNATIONAL LOGISTICS

The Logistics Information System (LIS) is made up of the following information systems:
Sales Information System
Purchasing Information System
Inventory Controlling
Shop Floor Information System
Plant Maintenance Information System
Quality Management Information System
Retail Information System (RIS)

Transport Information System (TIS)

The information systems that belong to LIS have a modular structure, yet have a variety of techniques that allow you to evaluate data. This type of structure also allows the individual information systems to retain their special features.

The Logistics Information System allows you not only to evaluate actual data, but also to create planning data. The information systems provide easy-to-use planning functions that are

Rules for Sea and Inland Waterway Transport

Free Alongside Ship (FAS)

Seller clears the goods for export and delivers them when they are placed alongside the vessel at the named port of shipment. Buyer assumes all risks/costs for goods from this point forward.

Free on Board (FOB)

Seller clears the goods for export and delivers them when they are onboard the vessel at the named port of shipment. Buyer assumes all risks/cost for goods from this moment forward.

Cost and Freight (CFR)

Seller clears the goods for export and delivers them when they are onboard the vessel at the port of shipment. Seller bears the cost of freight to the named port of destination. Buyer assumes all risks for goods from the time goods have been delivered on board
the vessel at the port of shipment.

Cost, Insurance, and Freight (CIF)

Seller clears the goods for export and delivers them when they are onboard the vessel at the port of shipment. Seller bears the cost of freight and insurance to the named port of destination. Seller's insurance requirement is only for minimum cover. Buyer is responsible for all costs associated with unloading the goods at the named port of destination and clearing goods for import. Risk passes from seller to buyer once the goods are onboard the
vessel at the port of shipmen

Due to national differences, it may pay a firm to base each value creation activity it performs at that location where factor conditions are most conducive to the performance of that activity. This strategy is referred to as focusing on the attainment of local economies. By rapidly building sales value for a standardized product, international expansion can assist a firm in moving down the experience curve.

International expansion may enable affirm to earn greater returns by transferring the skills and product offerings derived from its core competencies to markets where indigenous competitors lack those skills and product offerings.

A multinational firm can create additional value by identifying valuable skills created within its foreign subsidiaries and leveraging those skills within its global network of operations. The best strategy for a firm to pursue often depends on a consideration of the pressure for cost reductions and for local responsiveness.

8.12 SUMMARY

The lesson explained how efficient manufacturing and logistics functions can improve an international business competitive position by lowering the costs of value creation and by performing value creation activities in such ways that customer service is enhanced and value added is maximized.

We also examined closely at three issues central to international manufacturing and logistics management, where to manufacture, what to make and what to buy, and how to coordinate a globally dispersed and supply system.

8.13 KEYWORDS

- **Economies of Scale**- Cost advantages associated with large scale production.
- **Flexible Manufacturing Technology**- Manufacturing technologies designed to improve job scheduling, reduce setup time, and improve quality control.
- **Global Strategy**- Strategy focusing on increasing profitability by reaping cost reductions from experience curve and location economies.
- **International Strategy-**Trying to create value by transferring core competencies to foreign markets where indigenous competitors lack those competencies.
- **Mass Customization-** The production of a wide variety of end products at a unit cost that could once be achieved only through mass production of a standardized output.
- **Materials Management-** The activity that controls the transmission of physical materials through the value chain, from procurement through production and into distribution.
- **Multi-domestic Strategy-** Emphasizing the need to be responsive to the unique conditions prevailing in different national markets.
- **Total Quality Management (TQM)**- Management philosophy that takes as its central focus the need to improve the quality of a company's products and services.
- **Trans-national Strategy-** Plan to exploit experience-based cost and local economies, transfer core competencies with the firm, and pay attention to local responsiveness.

8.14 REVIEW QUESTIONS

1. What is international logistics? Discuss its main components.
2. In a world of zero transportation costs, no trade barriers and nontrivial differences between nations with regard to factor conditions, firms must expand internationally if they are to survive.
3. Discuss how the need for control over foreign operations varies with the strategy and core competencies of a firm? What are the implications of this for the choice of entry mode?
4. What do you see as the main problems likely to be associated with implementation of a transnational strategy

8.15 SUGGESTED READINGS

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LESSON – 9
INTERNATIONAL BUSINESS AND LEAST DEVELOPED COUNTRIES (LDC)

OBJECTIVES

- To Understand the characteristics of Least Developed Countries
- To know the Opportunities and challenges faced by Least Developed Countries in international Business Environments
- To Analyse the role of Least Developed Countries in international Business
- To study the Sustainable Development Goals and LDC development strategies
- To Evaluate the performance of Least Developed Countries in international Business

STRUCTURE

9.1 Introduction to Least Developed Countries
9.2 Characteristics of Least Developed Countries
9.3 Challenges faced by Least Developed Countries
9.4 Opportunities of Opportunities of Least developed Countries
9.5 Sustainable Development Goals and LDC development strategies
9.6 Performance of Least Developed Countries in International Business
9.7 Role of Least Developed Countries in International Business
9.8 Performance of Asia-Pacific LDCs in International Trade
9.9 Summary
9.10 Keywords
9.11 Self- Assessment questions
9.12 Further Readings

9.1 INTRODUCTION

Least-developed countries (LDCs) (sometimes referred to as less-developed countries) are underdeveloped countries that face significant structural challenges to sustainable development. The UN's list of LDCs currently comprises 46 countries. Least-developed countries are low-income countries that face significant structural challenges to sustainable development. The United Nations Committee for Development Policy created measures to help LDCs gain access to and benefit from international support.

The concept of "the least developed countries" became current in the decolonization period of the 1960s and was formalized in 1971 in UN General Assembly resolution 2768, which approved a list of the LDCs. Since then, UN Conferences on the Least Developed Countries have been held at ten year intervals, with the fifth originally scheduled to meet in March 2021 but postponed due to COVID-19 and then divided into two parts – a short session held in New York on 17 March 2022, and the main event, due to convene in March 2023 in Doha, Qatar. The Doha Programme of Action for the Least Developed Countries for the Decade 2022–2031 was adopted at the first part of the Fifth UN Conference on the Least Developed Countries and endorsed by the General Assembly on 1 April 2022.

The list of the LDCs is reviewed every three years by the independent expert Committee for Development Policy and designations made on the basis of three criteria:

gross national income per capita, a human assets index, and an economic and environmental vulnerability index. On this basis, countries are able to graduate to developing country status, and six have done so over the years.

The Committee for Development Policy (CDP), a subsidiary body of the Economic and Social Council, is responsible for reviewing the status of least developed countries (LDCs) and for monitoring their progress after graduation from the category. Six countries have so far graduated from LDC status: Botswana in 1994, Cape Verde in 2007, Maldives in 2011, Samoa in 2014, Equatorial Guinea in 2017, and Vanuatu in 2020.

The 46 current LDCs comprise around 880 million people, 12 percent of the world population. These LDC countries face severe structural impediments to growth and account for less than 2 percent of world GDP and around 1 percent of world trade. The CDP reviews the list of least developed countries every three years. The 46 countries currently on the list of LDCs include:

Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, Central African Republic, Chad, Comoros, Democratic Republic of the Congo, Djibouti, Eritrea, Ethiopia, Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, Lao People`s Dem. Republic, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, South Sudan, Sudan, Timor-Leste, Togo, Tuvalu, Uganda, United Republic of Tanzania, Yemen, Zambia.

9.2 CHARACTERISTICS OF LEAST DEVELOPED COUNTRIES:

Varying income inequality ,Varying political systems, Small political elite, Low political institutionalization, Most had experience of colonialism, Extended family, Peasant agricultural societies (LICs), High proportion of labor force in agriculture, High proportion of output in agriculture, Inadequate technology & capital, Low saving rates , Dual economy, Varying dependence on international trade, Rapid population growth (1.6% to DCs' 0.1% yearly), Low literacy & school enrollment rates, Unskilled labor force and Poorly developed institutions.

9.2.1 Weak economic growth: Average growth in LDCs stood at 4.7% during 2011–19, which was significantly lower than the average of 6.6% during 2001–10. This implies that the living standards of many LDCs will not converge to the levels of the fast-growing developing countries in North and South-East Asia. With the onset of the pandemic in 2020, economic growth has been particularly affected in 2020 and 2021, leading to sharp increases in poverty.

9.2.2 Lack of productive capacity. The gap in productive capacity of LDCs and other developing countries has not narrowed in the last ten years. There has been very little diversification into manufacturing or high-value services. Agriculture still remains the major source of value added and employment.

9.2.3 Lack of diversification of exports and high commodity dependence. We see an excessive dependence on a few products in the export baskets of many LDCs. Many countries seem to specialise in one or two products with respect to exports. This means that they are vulnerable to trade shocks and the sudden loss of export markets when another developing country becomes competitive in that product.

9.2.4 High vulnerability to environmental shocks. Extreme weather events have an adverse effect on LDCs. For example, Myanmar is the second most climate risk-affected country in the world. Climate change also poses serious threats to the Pacific Islands LDCs.

9.2.5 Potential loss of preferential market access such as the EU's 'Everything But Arms' (EBA) for the LDCs that are in the process of graduating. As most of the successful exporters among LDCs specialise in products that are price-sensitive such as apparel, the possible tariff increases may lead to big losses in competitiveness.

9.3 CHALLENGES FACING LEAST DEVELOPED COUNTRIES

LDCs are facing challenges similar to those they were already confronting a decade ago, and these are severely impacting their ability to recover from the ongoing pandemic. It is in these challenging circumstances that the Fifth United Nations Conference on the Least Developed Countries (LDC5) will be held. LDC5 should aim to forge a renewed partnership between LDCs and their trading and development partners over the next decade, in order to build a strong foundation of enhanced economic growth and resilience in LDCs that will overlap with the remaining years of the 2030 Agenda for Sustainable Development.

The Istanbul Programme of Action for LDCs (IPoA) for the decade 2011 to 2020 identified trade as one of the eight priority areas of actions for the economic growth and sustainable development of least-developed countries (LDCs).1 Calls from the international community to support the integration of LDCs into global trade have been resonating in the WTO over the last decade.

9.3.1 Soaring debt Even before the COVID-19 pandemic, UNCTAD warned about the climbing debt burden of LDCs, which undermines their ability to provide basic services, such as health care and education. Their debts have not only grown but also become costlier and riskier. Between 2011 and 2019, LDCs' debt service more than tripled to $33 billion, which represents between 5% and 13% of the value of their exports. The pandemic has exacerbated the situation, with LDCs' debt repayments set to hit $43 billion in 2022.

Such a burden will jeopardize their COVID-19 recovery efforts and sap the public funds needed to fight poverty and invest in essential infrastructure, such as roads and hospitals. Export marginalization LDCs also remain marginalized in global trade. Their share of global merchandise exports has hovered around just 1% since 2010.And their main exports leave them highly vulnerable to global crises and shocks.

Although several LDCs have broadened their export base, as many as 38 of them remain commodity dependent. They rely on primary goods like copper, cotton and oil for over 60% of their merchandise exports. Global commodities' markets are very volatile, and when prices crash, so do exports, jobs and government revenue. This volatility is a serious threat to many LDCs, especially for food and fuel. The impact of the war in Ukraine on global prices for these two products is a stark reminder.

9.3.2 Energy poverty UNCTAD calculations show that more than half of the people in LDCs still lacked access to electricity in 2019. About 570 million men, women and children in these countries don't have light at night for reading and aren't able to charge a mobile phone. The situation is worse in rural areas, with about two thirds of the population (458 million people) living

without electricity. And where electricity is available, such as in large cities, access is often unreliable.

Access to energy matters now more than ever as LDCs try to recover from the COVID-19 crisis. For example, without reliable electricity, hospitals can't refrigerate vaccines. This hampers vaccine roll-out efforts.

9.3.3 Climate vulnerability LDCs are on the front lines of the climate crisis even though their populations have barely contributed to the global greenhouse gas emissions fuelling global heating. In the past five decades, these vulnerable nations have been home to 69% of the global deaths caused by climate disasters. Yet their cars and industries have produced just 1.1% of the world's total CO2 emissions.

9.3.4 Export marginalization LDCs also remain marginalized in global trade. Their share of global merchandise exports has hovered around just 1% since 2010. And their main exports leave them highly vulnerable to global crises and shocks. Although several LDCs have broadened their export base, as many as 38 of them remain commodity dependent. They rely on primary goods like copper, cotton and oil for over 60% of their merchandise exports. Global commodities' markets are very volatile, and when prices crash, so do exports, jobs and government revenue. This volatility is a serious threat to many LDCs, especially for food and fuel. The impact of the war in Ukraine on global prices for these two products is a stark reminder.

Even their share per person barely reaches 9% of the world's average. In 2019, the carbon footprint of an average person living in an LDC was 23 times smaller than that of someone in a developed country, such as the United States or a European nation. This "climate apartheid" means that the people least responsible for climate change are the most affected by its consequences

9.4 OPPORTUNITIES OF LEAST DEVELOPED COUNTRIES

Major advances have been made in enhancing trade opportunities for LDCs, as well as in providing continued flexibilities to implement WTO rules and disciplines. A set of concrete decisions aimed at improving market access for LDC products, such as duty-free and quota-free (DFQF) market access, preferential rules of origin and the LDC services waiver, indicate members' commitment to LDCs' development, while WTO members' generous extension until 1 July 2034 of the transition period for LDCs under the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) attests to members' willingness to allow LDCs sufficient time to integrate WTO rules. LDCs have also received special treatment in the implementation of multilateral agreements like the WTO Trade Facilitation Agreement (TFA), which has the potential to reduce trade costs in LDCs.

LDCs thus continue to remain at the heart of the development dimension of the multilateral trading system. At the same time, LDCs have not been able to take full advantage of the opportunities provided under the multilateral trading system, and their participation in global trade has not reached the desired level.

The latest LDC Trade Ministers' Declaration, adopted in October 2021, stressed the importance of the speedy recovery of LDCs from the ongoing pandemic through increased trade opportunities.2 It set out LDC trade priorities, including the effective implementation of commitments in favour of LDCs and positive actions on LDC graduation. Other priority areas include specific treatment of LDCs in the disciplines on fisheries subsidies, agriculture,

development and trade-related response to the COVID-19. The beneficial integration of LDCs into global trade continues to be a priority, and the international community must reaffirm its commitment to and support of LDCs, so that trade can continue to be a fundamental driver of their development goals.

The IPoA goal of doubling the share of LDCs in global exports by 2020 was not met. LDCs' trade performance is conditioned by their weak productive and institutional capacity, narrow export base and limited market destinations, continued and widening trade deficit, susceptibility to high price volatility for primary commodities, and, most recently, by the declining demand and global economic contractions resulting from the ongoing COVID-19 pandemic.

9.5 SUSTAINABLE DEVELOPMENT GOALS AND LDC DEVELOPMENT STRATEGIES

Accelerated economic development in the least developed countries (LDCs) is at the centre of efforts to achieve the Sustainable Development Goals (SDGs). Not only is the incidence of poverty and malnutrition the greatest in this group of countries, but the selection and implementation of effective policies to overcome these problems are also the most challenging there. The SDGs comprise several goals which explicitly refer to income growth, employment creation and industrialization. The achievement of all other goals also depends on progress made on the economic front. Some SDGs are important reference points for the design of national development strategies for least developed countries.

- End poverty in all its forms everywhere
- End hunger, achieve food security and improved nutrition and promote sustainable agriculture
- Ensure access to affordable, reliable, sustainable and modern energy for all
- Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
- Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation
- Reduce inequality within and among countries
- Take urgent action to combat climate change and its impacts
- Strengthen the means of implementation and revitalize the Global Partnership for Sustainable Development

9.6 PERFORMANCE OF LDCS IN INTERNATIONAL TRADE (2011 TO 2020)

From 2011 to 2020, the share of LDCs in global exports declined from 0.95 per cent to 0.91 cent (see Figure 1). This is a disappointing result compared to the IPoA's target to double LDCs' share in global exports over the same period. The COVID-19 pandemic has only exacerbated the subdued trade performance registered by LDCs in the latter half of the IPoA implementation period. The COVID-19 pandemic has had a severe trade impact on LDCs. In the second quarter of 2020, when many lockdown measures began or were already in force, LDC merchandise exports declined 30 per cent year-on-year, compared to a 21 per cent drop in merchandise exports at the world level. Overall, in 2020, LDC merchandise exports shrank by nearly 12 per cent in value terms, compared to the more than 7 per cent contraction for the world as a whole. Exports of primary commodities, such as fuel and mining products, have been hit hard with a drop of -41 per cent. Manufacturing plants shut

down due to COVID-19 restrictions, and spending dropped due to stay-at-home orders; these effects translated into low demand for primary commodities from LDCs. The LDC exports of commercial services also declined more sharply than the global average, at -35 per cent compared to -21 per cent, reflecting the disproportionate share of tourism and travel to LDCs.

The LDC trade profile continues to be characterized by concentration in specific products and markets. A limited number of the LDCs account for a larger share of exports of the LDC group. The top ten LDC exporters represented more than 80 per cent of LDC merchandise exports in 2011; this declined to 73 per cent in 2020 (see Annex Table 1). LDC exports continue to be concentrated in five major destination markets: China, the European Union, the United States, India and Thailand. Due to the sharp fall in the prices of primary commodities, there has been a distinct change in the commodity mix of LDC exports over the last decade (see Figure 2). In 2011, primary products (mainly petroleum products) dominated exports with a share of 73 per cent of LDC merchandise exports. In 2020, the share of primary products declined to 48 per cent, due in particular to the sharp fall in the prices of fuels, while LDC exports of clothing registered a higher share in merchandise exports (up from 13 per cent in 2011 to 30 per cent in 2020). Over the past decade, LDC merchandise export growth has seen sharp fluctuations, and it registered a negative growth rate in 2020 compared to its strong growth performance in 2011 (see Figure 3).

9.7 Role of Least Developed Countries in International Business

The share of LDCs in world merchandise trade stood at 1.01 per cent in 2020, down from 1.06 per cent in 2011. From 2011 to 2019, world exports increased at an annual rate of 0.4 per cent, whereas LDC exports increased by just half of that (0.2 per cent). One important reason for this has been the volatility of prices of primary commodities. Thus, from 2011 to 2020, the annual export growth of oil-exporting LDCs was negative because fuel prices in 2020 dropped to half those of 2011. This volatility in primary commodity prices was exacerbated by the COVID-19 pandemic and the subsequent interruption to global economic activity. Many LDCs face the challenge of a chronic trade deficit. From 2011 to 2019, there was a fivefold increase in the merchandise trade deficit of LDCs.

The economic growth of many LDCs caused a higher demand for products, which are often not produced in LDCs. In addition, many LDCs are unable to move away from exporting primary goods. A combination of these factors has led to the worsening of their trade deficit. From 2011 to 2019, there was a 7 per cent annual growth of manufactured exports in LDCs, and over the past decade, the general LDC export structure has seen a gradual decline in primary products because of lower revenues from oil exports, and an increase in manufactured goods due to a growing share of clothing exports. In terms of merchandise exports, manufactured goods still only account for 40 per cent for LDCs, compared to 66 per cent for the rest of the world. From 2011 to 2019, LDCs experienced a 6.8 per cent annual growth in commercial services exports, and the world share of LDC services exports increased from 0.59 per cent to 0.72 per cent. However, there has not been a discernible improvement from a low supply base. In 2020, services exports for LDCs dropped by a staggering 40 per cent, more than double the drop in world services exports.

The share of LDCs in world commercial services exports accounted for a marginal 0.53 per cent in 2020, down from 0.6 per cent in 2011 (see Figure 4). For some countries, such as Comoros, Ethiopia and The Gambia, services exports constitute more than half of their total exports (Annex Table 2). Only a handful of LDCs, such as Bangladesh, Myanmar,

Nepal and Senegal, have been able to make meaningful progress in exporting more sophisticated services exports, such as finance, computer services and professional services; however, tourism and business travel remain the primary service sector exports in LDCs. Because of this, LDCs services exports have been hit particularly hard by COVID-19. Travel exports dropped 88 per cent year-on-year in the second quarter of 2020 due to travel restrictions and lockdowns, and they hardly recovered in the third and fourth quarters. Although the shock caused by COVID-19 to service export demand is probably temporary, it is still crucial that LDCs build their supply side capacity for services to diversify their economies.

9.8 PERFORMANCE OF ASIA-PACIFIC LDCS IN INTERNATIONAL TRADE

The ministerial decision on Duty-Free and Quota-Free Market Access for Least Developed Countries essentially brings the United States on board so that it extends coverage of DFQF market access to LDCs prior to the next ministerial conference in December 2014 without waiting for the conclusion of the DDA. The decision should have major impacts on the exports of Asia-Pacific LDCs, especially Bangladesh, Cambodia, Nepal, Bhutan, the Lao PDR and Samoa, for which the United States is an important destination for exports. Notably, Bangladesh and Cambodia are among the top 10 countries that face high United States customs duties (table 2.12). This is because the major export products, i.e., apparel, of these countries are outside the scope of the GSP scheme of the United States.

Asia-Pacific LDCs should be aware that extending DFQF market access to all LDCs may have significant ramifications for the exports of African and Caribbean countries such as Lesotho, Mauritius, Kenya and Haiti. These ramifications explain the strong opposition from these countries during WTO negotiations on DFQF market access. The decision agreed on by WTO Members is non-binding and merely obliges the United States to "seek" to improve its DFQF coverage prior to the next ministerial conference. It notably does not guarantee extension of coverage up to 97 per cent. Therefore, in order to realize the opportunities set out in this decision, Asia-Pacific LDCs need to do some groundwork so that the United States comes up with a package that satisfies them while keeping in mind the interests of African LDCs. This will be a big challenge for the Asia- Pacific LDCs.

In this regard, it is necessary for Asia-Pacific LDCs to understand whether or not there will be any gain for each of them with product coverage of 97 per cent by the United States. They need to know which sectors would benefit from liberalization and howtheir economies would be affected overall. Such work can be conducted by ESCAP and followed up with dissemination activities at the national or sub-regional LDC cluster levels. Asia-Pacific LDCs could consider the preparation of a joint list of demands with which they could approach the United States. ESCAP can provide support by organizing

Brief Assessment of the Key Decisions at the Bali Ministerial Conference and Issues of Importance to LDCs

Decisions reached at the Bali Ministerial Conference can be grouped into three broad categories:

- The following decisions fall under *decisions with definitive outcomes*:

- Agreement on Trade Facilitation
- The inclusion of general service programmes related to land and rural livelihoodsecurity in paragraph 2 of Annex 2 of the Agreement on Agriculture
- Public Stockholding for Food Security Purposes
- Understanding on Tariff Rate Quota Administration Provisions of AgriculturalProducts, as Defined in Article 2 of the Agreement on Agriculture
- Monitoring Mechanism on Special and Differential Treatment

The following decisions fall under decisions without definitive outcomes:

  - Export Competition
  - Cotton
- Preferential Rules of Origin for Least-Developed Countries
- Operationalization of the Waiver Concerning Preferential Treatment to Servicesand Service Suppliers of Least-Developed Countries
- Duty-Free and Quota-Free (DFQF) Market Access for Least-Developed Countries
- Decision on the preparation of a clearly defined work programme on the remainingDDA issues by December 2014

Three of the decisions under the first category, namely the decisions on refraining from challenging in cases of public stockholding for food security purposes by developing countries, the inclusion of general service programmes related to land and rural livelihood security, and the Monitoring Mechanism on Special and Differential Treatment, are pertinent to developing countries including LDCs. However, the first two decisions do not bring any benefits to LDCs since aggregate measurement of support in LDCs is reportedly well below the de minimis level. The decision on TRQ administration is not relevant for LDCs since no LDC maintains TRQs. The Agreement on Trade Facilitation is of importance to LDCs because it requires them to undertake obligations. The decision to prepare a clearly defined work programme on the remaining DDA issues is also pertinent to LDCs because it requires them to raise their demands regarding.

Implications for Asia-Pacific LDCs

Rules of origin under any preferential scheme are the key determinant that enables LDCs to take advantage of the preferential access granted by preference-giving countries. As shown in table 2.7, statistics for the top 10 export destinations of Asia-Pacific LDCs indicate that countries currently providing duty-free market access to LDCs are among these top destinations. Therefore, Asia-Pacific LDCs will benefit most if these countries apply favourable RoO requirements along with wider coverage of DFQF products.

The data for performances of individual Asia-Pacific LDCs that benefit from preferences granted by preference-giving countries are not available for all countries. The United States International Trade Center and Eurostat make data on total trade and trade underGSP schemes available on their websites. The United States does not provide duty-free

market access for major export products of Asia-Pacific LDCs and it has not reviewed its RoO in the light of LDC demands. Therefore, the import data of the United States may not be appropriate for assessing the impact of duty-free access and RoO. On the other hand, the European Union has been providing DFQF market access to all products except arms under the Everything but Arms (EBA) initiative since 2001. It even introduced more relaxed rules of origin for LDCs in 2011. Therefore, it is pertinent to examine the historical import data of the European Union and assess the impacts of these European Union initiatives.

In the year 2000, prior to the EBA initiative, GSP utilization rates were comparatively low for almost all Asia-Pacific countries except Nepal and the Solomon Islands. Between 2001 and 2010, Bangladesh, Cambodia, the Lao PDR and the Solomon Islands were able to increase their utilization rates and exports to the European Union. However, despite improvement in its utilization rate, Nepal saw its exports decline during that period, possibly due to the phasing out, in 2005, of the Multi- Fibre Arrangement.

A significant increase in utilization rates among Asia-Pacific LDCs has been observed since 2011, when the European Union introduced new RoO with more relaxed criteria for LDCs. A closer look at Asia - Pacific LDC export growth during 2000–2010 and 2011– 2013 (table 2.9) shows that while the EBA initiative brought substantial benefits to some Asia-Pacific LDCs during 2000-2010, the benefits were even greater during 2011-2013. Bangladesh, Cambodia, Bhutan, the Lao PDR and the Solomon Islands are among the Asia-Pacific LDCs that have been benefitting from the European Union's relaxed RoO. Seemingly, other countries except Myanmar, which had been outside GSP schemes until July 2013, were unable to utilize GSP benefits. Low utilization of GSP benefits could be attributed to low productive capacities or high compliance costs in those countries. Therefore, it can be deduced that Asia-Pacific LDCs are likely to benefit from any revision of preferential RoO by preference-giving countries following the adoption of the ministerial decision. In this context, Asia-Pacific LDCs will need to assess their productive capacities in order to determine their comfort zones so that they can pursue adoption accordingly.

Imports of the United States from Asia-Pacific LDCs and duties faced by LDCs

Country	Import Value in $ Millions				Import-Weighted Average Duty (%)			
	2010	2011	2012	2013	2010	2011	2012	2013
Afghanistan	84.84	20.09	33.16	40.05	0.02%	0.13%	0.09%	0.12%
Bangladesh	4,273.56	4,869.46	4,878.40	5,303.45	15.26%	15.32%	15.00%	15.62%
Bhutan	0.40	0.52	0.61	0.54	1.87%	0.33%	1.18%	1.88%
Myanmar	0.00	0.00	0.04	29.91			0.00%	1.22%
Cambodia	2,288.67	2,710.74	2,675.33	2,748.82	16.39%	16.93%	16.89%	16.84%
Kiribati	1.02	0.65	0.60	1.02	0.10%	0.00%	0.55%	0.00%
Lao PDR	55.30	55.05	25.41	29.73	8.04%	7.71%	9.88%	8.41%
Nepal	60.09	77.61	83.26	77.87	3.66%	3.36%	2.98%	3.22%
Solomon Islands	0.99	1.31	1.57	8.83	0.08%	0.04%	0.03%	0.02%
Timor-Leste	0.00	0.03	0.10	0.12		0.00%	0.00%	1.44%
Tuvalu	0.02	0.00	0.04	0.03	1.21%	0.84%	1.82%	0.00%
Vanuatu	1.59	1.86	2.60	4.14	0.03%	0.02%	0.07%	0.00%
Yemen	181.36	536.39	87.11	65.59	0.00%	0.01%	0.00%	0.01%
Total	**6,951.19**	**8,276.68**	**7,790.61**	**8,314.55**	**14.87%**	**14.64%**	**15.26%**	**15.59%**

Operationalization of the Waiver Concerning Preferential Treatment to Services and Service Suppliers of Least-Developed Countries

Assessment of the Decision

At the Eighth WTO Ministerial Conference held in Geneva in 2011, ministers adopted the decision, "Preferential Treatment to Services and Service Suppliers of Least-Developed Countries, which enabled developed and developing country members to provide preferential market access to LDCs in the area of services. The decision is a waiver that, when granting trade preferences to LDCs, exempts WTO Members from their legal obligation to provide non-discriminatory treatment through the most - favoured nation (MFN) principle to all trading partners. The services waiver was initially for 15 years from the date of adoption. The waiver authorized the provision of preferences to LDCs in six categories of market access listed in General Agreement on Trade in Services (GATS) Article XVI, and established the requirement of authorization from the WTO Council for

Trade in Services for any measures outside the scope of those six categories.

While this waiver represents a major achievement for LDCs, it, like the 1979 Enabling Clause, does not oblige WTO Members to offer preferential treatment to LDCs. Unlike the trade in goods, the trade in services is regulated by complex rules and regulations. Therefore, reaching a decision on a waiver for the trade in services required extensive discussions among key countries. From this perspective, the Bali Ministerial decision on Operationalization of the Waiver Concerning Preferential Treatment to Services and Service Suppliers of Least-Developed Countries (WTO, 2013g) is undoubtedly a significant step forward for LDCs in taking advantage of the international trade in services.

The need for a decision on operationalization of the services waiver emerged from GATS Article IV.3, which stipulates that special priority through specific negotiated commitments is to be given to LDCs in the liberalization of market access in sectors and modes of supply of export interest to LDCs. However, no mechanism was put in place to operationalize this article. GATS Article XIX.3 prescribes the preparation of negotiation guidelines in each round of trade negotiations and emphasises special treatment for LDCs (as per Article IV.3 as discussed above). Accordingly, when guidelines and procedures for negotiations on the trade in services were adopted in March 2001, prior to commencing a new round of negotiations on liberalization, it was agreed that special priority would be granted to LDCs as stipulated in Article IV.3.

In September 2003, WTO Members established the modalities for the special treatment of LDCs in negotiations on the trade in services. It was agreed that members would work to develop "appropriate mechanisms" with the view to achieve full implementation of GATS Article IV.3 and securing access to foreign markets for LDCs' services and service suppliers. In order to initiate discussions on a special mechanism, LDCs submitted a proposal in March 2006 seeking to establish a mechanism that obligates developed countries to grant permanent, non-reciprocal, special priority solely to LDCs, "notwithstanding any provision of the GATS" (Zambia, 2006). Later, the European Union submitted a proposal on an approach that requires the submission of reports by non-LDC members indicating how their current DDA offers provide special priority to LDCs regarding the trade in services. In 2008, the WTO Secretariat presented three options for developing an appropriate mechanism: (a) amendment of GATS; (b) a waiver from the MFN obligation; or (c) an understanding on the application of GATS Article IV.3. WTO Members agreed to work on a waiver in July 2008. Thereafter, discussions were led and facilitated by Norway, and ultimately WTO Members adopted the decision, Preferential Treatment to Services and Service Suppliers of Least-Developed Countries.

After the adoption of the decision, discussions about operationalization of the waiver were initiated. With regard to operationalization, it is pertinent to refer to the 1979 Enabling Clause. Although the Enabling Clause and the 2011 services waiver have similarities in many areas, operationalization of these two decisions requires different approaches. The first and foremost reason for different approaches is that developed countries did not find any difficulty in granting preferential access for goods because there was existing practice of such treatment, while no country had any experience in providing preferential market access for services. Second, while preferential access for goods is straightforward through tariff reduction, preferential access for services requires changes in domestic laws and regulations related to specific sectors. Third, the services waiver requires reading along with the modalities for the special treatment of LDCs established in September 2003 – which

encourage LDCs to indicate those sectors and modes of supply that are priorities in their development policies – so that preference-giving members take the priorities into account during negotiations.

The services waiver stipulates that: "Any preferential treatment accorded pursuant to this Waiver shall be designed to promote the trade of least-developed countries in those sectors and modes of supply that are of particular export interest to the least developed countries" (WTO, 2011). Identification by LDCs of their sectors and modes of supply of export interest is a prerequisite for operationalization of the services waiver; however, there is no prior practice to guide WTO Members in their own initiatives as there was in the case of the trade in goods. The last but least important factor is that Members must define the approach to be taken for granting preferential access within the parameters of GATS Article XVI. All of these issues make operationalization of the services waiver very complex. In this context, the adoption of the decision on operationalization of the services waiver was much needed.

Country	GDP (current $ million)	GDP growth (%), 2012	Per capita GDP	Income Level	Trade as % of GDP	Geographical characteristics	Membership status in WTO
Afghanistan	20,497	14.4	687	Low	44.7	Landlocked	Observer
Bangladesh	116,355	6.2	752	Low	55.3	Direct access to sea	Member
Bhutan	1,780	9.4	2,399	Lower middle	87.3	Landlocked	Observer
Cambodia	14,038	7.3	944	Low income	113.6	Direct access to sea	Member
Kiribati	175	2.8	1,736	Lower middle	117.1	Small island	Not applied
Lao PDR	9,418	8.2	1,417	Lower middle	84.7	Landlocked	Member
Myanmar	NA	NA	NA	Lower middle	NA	Direct access to sea	Member
Nepal	18,963	4.9	690	Low	43.4	Landlocked	Member

Implications of the Decision on Operationalization of the Services Waiver for Asia-Pacific LDCs

Realizing the benefits of the decisions on the services waiver and its operationalization will largely depend on the abilities of Asia-Pacific LDCs to integrate into the international services market. Available statistics on the role of service sectors in Asia-Pacific LDCs show that although they play major roles in the economic development of these countries, service sectors represent relatively small shares in the international trade of most

of these countries. Five Asia-Pacific LDCs – Afghanistan, Nepal, Timor- Leste, Tuvalu and Vanuatu – are mainly service exporters (UNCTAD, 2013). Three others export both manufactured goods and services. For most of these countries, remittances are an important component of gross national income, as shown in table

Remittances mainly come from citizens who work abroad and send money back to their home country. Although balance of payments statistics do not count remittance inflows as service inflows, many categories of work done by the citizens of Asia-Pacific LDCs may fall under Mode 4 of service supply, the movement of natural persons. Therefore, preferential treatment envisaged in decisions on the services waiver and its operationalization in regard to Mode 4 of service supply will largely benefit most Asia- Pacific LDCs.

Country	GDP (current $ million)	GDP growth (%), 2012	Per capita GDP	Income Level	Trade as % of GDP	Geographical characteristics	Membership status in WTO
Solomon Islands	1,008	3.9	1,835	Lower middle	69.1	Small island	Member
Timor-Leste	1,293	0.6	1,068	Lower middle	125.6	Small island	Not applied
Tuvalu	40	0.2	4,044	Upper middle	NA	Small island	Not applied
Vanuatu	787	2.3	2	Lower middle	98.2	Small island	Member
Yemen	35,646	0.1	1,494	Lower middle	65.1	Direct access to sea	Observer

Trade performances of the Asia-Pacific LDCs show that volumes of merchandise exports vary, and only five countries exceeded annual export volumes worth $1 billion during the past five years. During that period, exports of all Asia-Pacific LDCs except Afghanistan registered positive growth figures, as demonstrated in table 2.3. Regarding merchandise imports, all LDCs except Vanuatu registered increases during the past five years and annual import volumes of eight Asian LDCs exceeded $1 billion, as shown in table 2.4. In the area of services, service exports are significant for four LDCs, Afghanistan, Nepal, Timor-Leste and Vanuatu, and the values of service exports for these countries exceed values of merchandise exports. For other countries, service exports are not significant compared with merchandise exports and there is no evidence of the increased importance of service exports in any country other than Bhutan, as shown in table 2.5. Regarding services imports, all Asia-Pacific LDCs registered growth during the past five years, although annual growth rates fluctuated for individual countries, as shown in figure 2.1. Despite variations in export and import volumes among the Asia- Pacific LDCs, trade evidently plays significant roles in

these countries, given that trade- GDP ratios exceed 40 per cent in all the LDCs, and with some countries exceeding 100per cent (figure 2.2).

The major remaining question is how to actually operationalize the services waiver. As stipulated in the decision on operationalization, LDCs need to submit a collective request list. That means each country has to identify their sectors and modes of supply of export interest as well as the barriers to exporting faced by those sectors and modes of supply. This will be a gigantic task given the limited capacities of Asia-Pacific LDCs.

9.8 SUMMARY

Least-developed countries (LDCs) (sometimes referred to as less-developed countries) are underdeveloped countries that face significant structural challenges to sustainable development. The UN's list of LDCs currently comprises 46 countries. Least-developed countries are highly vulnerable to economic and environmental shocks and have fewer human assets than other nations. In some cases, least-developed countries are referred to as "emerging markets." LDCs have access to specific international support measures for development assistance and trade that are not available to more developed nations. More specifically, under IPoA, the world pledged to double the share of LDCs' exports in global exports to approximately 2% by 2020, including by broadening these countries' export base. The same objective was reaffirmed in 2015 in the UN's Sustainable Development Goal 17. While LDCs doubled their share of world exports from 0.55 % to 1.03% between 2001 and 2010, the term of the Brussels Programme of Action (BPoA), mainly due to a surge in commodity prices, their share of global merchandise exports has hovered around a mere 1% since 2010, as the above chart shows. Therefore, the IPoA target failed to materialize even before the COVID-19 pandemic hit.

9.9 KEY WORDS

Least Developed Countries
International Business
Sustainable developmental goals
Exports and Imports
Energy poverty
Merchandise Trade .

9.10 SELF ASSESSMENT QUESTIONS

1. Define Least Development Countries? Explain its characteristics.
2. Explain the Opportunities and challenges of LDC in International Business
3. Explain the role and performance of LDCs in International Business.

9.11 Further Reading

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LESSION-10
REGIONAL TRADE GROUPINGS AND COOPERATION

OBJECTIVES

- To Understand the importance of Regional Trade Grouping in International Business
- To know the various stages of Regional Trade Grouping and cooperation
- To know the advantages and disadvantages of Regional Trade Grouping
- To study the various important regional trade groups in international business
- To understand the functions and importance of various Regional Trade Grouping in International Business.

STRUCTURE

10.1 Introduction to Regional Trade grouping and cooperation
10.2 Types or stages of Regional Trade Grouping
10.3 Advantages of Regional Trade Grouping
10.4 Disadvantages of Regional Trade Grouping
10.5 Functions of various Regional Trade Grouping.
10.6 Summary
10.7 Keywords
10.8 Self- Assessment questions
10.9 Further Readings

10.1 INTRODUCTION

Regional trade blocs/ groupings are groups of countries that have formed a regional economic alliance in order to promote trade and economic cooperation within the region. Regional trade blocs are often formed as a way to reduce barriers to trade and to promote economic integration among member countries. A regional trading bloc (RTB) is a co-operative union or group of countries within a specific geographical boundary. RTB protects its member nations within that region from imports from the non-members. Trading blocs are a special type of economic integration.

There are many different types of regional trade blocs, and they vary in terms of the level of economic integration and cooperation that they promote. Some regional trade blocs are relatively loose arrangements that focus on reducing tariffs and other trade barriers, while others are more comprehensive and involve the creation of a single market or customs union among member countries.

Regional trade blocs can have a significant impact on international trade and economic relations, as they can create large markets and can shape the rules and standards that govern trade within the region. Regional trade blocs can also have implications for the global trading system, as they may create trade blocs that are larger than individual countries and that may have more bargaining power in negotiations with other countries or trade blocs.Examples of regional trade blocs include the European Union, the North American Free Trade Agreement (NAFTA), and the Association of Southeast Asian Nations (ASEAN).

10.2 TYPES / STAGES OF REGIONAL TRADE GROUPS

Trade blocs can be stand-alone agreements between several states (such as the North American Free Trade Agreement (NAFTA) or part of a regional organization (such as the European Union). Depending on the level of economic integration, the trade blocs can fall into the 6 different categories, such as preferential trading areas, the free trade areas, the customs unions, the common markets, the economic union & the monetary unions, & the political union.

10.2.1 Preferential Trade Area: Preferential Trade Areas (PTAs) exist when countries within a geographical region agree to reduce or eliminate tariff barriers on selected goods imported from other members of the area. This is often the first small step towards the creation of a trading bloc.

10.2.3 Free trade area: Free Trade Areas (FTAs) are created when 2 or more countries in a region agree to reduce or eliminate barriers to trade on all the goods coming from other members. This is the most basic form of economic cooperation. Member countries remove all barriers to trade among themselves but are free to independently determine trade policies with non member nations. **An example** is the North American Free Trade Agreement (NAFTA).

10.2.4 Customs union: This type provides for economic cooperation as in a free-trade zone. Barriers to trade are removed between member countries. The primary difference from the free trade area is that members agree to treat trade with non-member countries in a similar manner. The customs union involves the removal of the tariff barriers among the members, as well as the acceptance of the common (unified) external tariff in contradiction to the non-members. This means that the members may negotiate as a single bloc with third parties, such as with other trading blocs, or with the WTO. **The Gulf Cooperation Council (GCC)** Cooperation Council for the Arab States of the Gulf is an example.

10.2.5 Common market: A ‘common market’ is the first significant step towards full economic integration, & occurs when member countries trade freely in all economic resources – not just tangible goods. This means that all barriers to trade in goods, services, capital, & labor are removed. In addition, as well as removing tariffs, non-tariff barriers are also reduced & eliminated. For a common market to be successful there must also be a significant level of harmonization of macroeconomic policies, & common rules regarding monopoly power & other anti-competitive practices. There may also be common policies affecting key industries, such as the **Common Agricultural Policy** (CAP) & Common Fisheries Policy (CFP) of the European Single Market (ESM). This type allows for the creation of economically integrated markets between member countries. Trade barriers are removed, as are any restrictions on the movement of labor & capital between member countries. Like customs unions, there is a common trade policy for trade with nonmember nations. The primary advantage to the workers is that they no longer need the visa or work permit to work in another member country of the common market. **An example is the Common Market for Eastern & Southern Africa (COMESA).**

10.2.6 Economic & monetary union: This type is created when countries enter into an economic agreement to remove barriers to trade & adopt common economic policies. An example is the European Union (EU). Monetary union is a type of trade bloc which is composed of an economic union (common market & customs union) with a monetary union.

Monetary union is established through a currency-related trade pact. An intermediate step between pure monetary union & a complete economic integration is the fiscal union. Economic & Monetary Union of the European Union with the Euro for the Euro-zone members is the example of monetary union.

10.2.7 Political union: In order to be successful the more advanced integration steps are typically accompanied by the unification of economic policies (tax, social welfare benefits, etc.), reductions in the rest of the trade barriers, introduction of the supranational bodies, & gradual moves towards the final stage, a "political union". Political union is a final stage in the economic integration with more formal political links among the countries. A limited form of the political union may exist when two or more countries share common decision-making bodies & have common policies. It is the unification of previously separate nations. The unification of West & East Germany in 1990 is **an example** of the total political union.

10.3 ADVANTAGES OF REGIONAL TRADE GROUPS

10.3.1 Free trade within the bloc: Knowing that they have free access to each other's markets, members are encouraged to specialize. This means that, at a regional level, there is the wider application of the principle of the comparative advantage.

10.3.2 Market access & trade creation: Easier access to each other's markets means that trade between members is likely to increase. Trade creation exists when free trade enables high-cost domestic producers to be replaced by lower-cost & more efficient imports. Because low-cost imports lead to lower-priced imports, there is a 'consumption effect', with increased demand resulting from lower prices. These agreements create more opportunities for countries to trade with one another by removing the barriers to trade & **investment.** Due to a reduction or removal of tariffs, cooperation results in cheaper prices for consumers in the bloc countries.

10.3.3 Economies of scale: Producers can benefit from the application of scale economies, which will lead to lower costs & lower prices for consumers.

10.3.4 Jobs: Jobs may be created as the consequence of increased trade among the member economies. By removing the restrictions on the labor movement, economic integration can help expand job opportunities.

10.3.5 Protection: Firms inside the bloc are protected from cheaper imports from outside, such as the protection of the EU shoe industry from cheap imports from China & Vietnam.

10.3.6 Consensus & cooperation: Member nations may find it easier to agree with smaller numbers of countries. Regional understanding & similarities may also facilitate closer political cooperation.

10. 4 DISADVANTAGES OF REGIONAL TRADE BLOCS / GROUPS

10.4.1 Loss of benefits: The benefits of free trade among the countries in different blocs is lost.

10.4.2 Distortion of trade: Trading blocs are likely to distort world trade, & reduce the beneficial effects of specialization & the exploitation of comparative advantage.

10.4.3 Inefficiencies & trade diversion: Inefficient producers within the bloc can be protected from more efficient ones outside the bloc. **For example**, inefficient European farmers could be protected from low-cost imports from developing countries.

Trade diversion arises when the trade is diverted away from efficient producers who are based outside the trading area. The flip side to trade creation is trade diversion. The member countries may trade more with each other than with non member nations. This might mean increased trade with less efficient or more expensive producer because it is in a member country. In this sense, weaker companies can be protected inadvertently with the bloc agreement acting as a trade barrier. In essence, the regional agreements have formed new trade barriers with countries outside of the trading block.

10.4.4 Retaliation: The development of 1 regional trading bloc is likely to stimulate the development of others. This can lead to the trade disputes, such as those between the EU & NAFTA, including the recent Boeing (US)/ Airbus (EU) dispute. The EU & US have a long history of the trade disputes, together with the dispute over US steel tariffs, which were declared illegal by the WTO in 2005.

10.4.5 Employment shifts & reductions: Countries may move production to cheaper labor markets in member countries. Similarly, workers may move to gain access to better jobs & wages. Sudden shifts in employment can tax the resources of the member countries.

10.5 10 MAJOR REGIONAL TRADING GROUPS IN THE WORLD

Trade blocks are the groups of countries which are establishing the preferential trade arrangements among member countries. It is a group of countries within a specific geographical boundary. There are four types of trading bloc such as preferential trade area, free trade area, customs union and common market. Here is the list of 10 major regional trade blocs across the world.

- ASEAN
- APEC
- BRICS
- EU
- NAFTA
- CIS
- COMESA
- SAARC
- MERCOSUR
- IOR-ARC
- SAFTA

The main advantages of trade blocks results from an increase in FDI (Foreign Direct Investment) and tariffs are removed. Trade blocs are special type of economic cooperation and also protects its member countries within that region to imports from non-member countries. Let’s take a look at the trade analysis of major regional trade blocks.

10.5.1 ASEAN – Association of South East Asian Nations

ASEAN was established on 8th August 1967 in Bangkok, Thailand. There are 10 member countries of ASEAN including Brunei, Malaysia, Singapore, Vietnam, Indonesia, Laos, Cambodia, Thailand, Philippines and Myanmar. The main goals of ASEAN are to increase economic growth, social progress and promote regional space and stability. It aims to transform ASEAN into a single entity. Singapore is the biggest trading market of ASEAN countries. As per the trade map, ASEAN exports of goods to the global market worth USD 890 billion and imports worth USD 846 billion in the year 2017. However, the exports were USD 1183 billion and imports were USD 1105 billion during 2016.

The major goal of ASEAN was to hasten economic growth and, as a result, social and cultural progress. A secondary goal was to foster regional peace and stability based on the rule of law and the UN charter's principles.

Objectives of ASEAN:

- Increase economic growth and through that 'social progress and cultural development'
- Enhance regional peace and stability built on the rule of law and the principles of the United Nations Charter

India and ASEAN:

- The relationship between India and the Association of Southeast Asian Nations (ASEAN), which includes Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam, has progressed at a rapid rate since its inception nearly a decade ago
- In 1992, India was invited to join ASEAN's sectoral conversation
- During the fifth ASEAN Summit in Bangkok in 1995, ASEAN invited India to join the organisation as a full dialogue partner
- In 1996, India also joined the ASEAN Regional Forum. Since 2002, India and ASEAN have held annual summits
- India and the ASEAN nations signed a Free Trade Agreement (FTA) in Thailand in August 2009. According to a press statement from the Ministry of Commerce and In industry, between 2013 and 2016, ASEAN member countries and India will lower import duties on more than 80% of traded products under the ASEAN-India FTA
- The FTA on products was accepted by Singapore, Malaysia, and Thailand in January 2010
- The FTA is planned to be operationalized by the remaining seven ASEAN countries by August 2010
- India and ASEAN are now in the process of drafting agreements on services trade and investment
- The services talks are conducted on a request-offer basis, in which both parties submit requests for the opportunities they seek, and the receiving country responds with offers based on the requests

10.5.2 APEC – Asia Pacific Economic Cooperation

APEC also referred to member economies and accounting approximately 60% of the world's GDP. It is responsible for facilitating economic growth, cooperation, trade and investment in this region. APEC consists of 21 member countries including Brunei Darussalam, Canada, Chile, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Taipei, Thailand, United States and Vietnam. APEC exports of goods stood at USD 8021 billion and imports stood at USD 7997 billion during the year 2016. China and United States are the biggest trading countries.

Objectives of APEC

- To Sustain the growth and development of the region for the common good its peoples and, in this way, to contribute to the growth and development of the world economy.
- To enhance the positive gains, both for the region and the world economy, resulting from increasing economic interdependence, including by encouraging the flow of goods, services, capital and technology.
- To develop and strengthen the open multilateral trading system in the interest of Asia-Pacific and all other economies.
- To reduce barriers to trade in goods and services and investment among participants in a manner consistent with GATT principles, where applicable, and without detriment to other economies.

10.5.3 BRICS

BRICS is an association of five national economies such as Brazil, Russia, India, China and South Africa. However, South Africa has joined this group in the year 2010 and earlier it was known as BRIC. The total exports of BRICS amounted to USD 2902 billion and imports amounted to USD 2339 billion during 2017. China is the largest trading country in terms of both imports and exports among these countries and recorded 70% of BRICS exports and 65% of BRICS imports.

Objectives of BRICS

BRICS aims to increase economic and political stability. It is believed that by the end of 2050, these countries will be the main places where products, services, and raw materials come from. The main objectives of BRICS can be summarised as under-

- The main goal is to increase, deepen, and broaden cooperation among its member countries in order to promote growth that is sustainable, fair, and good for everyone.
- All of the members' growth and progress are taken into account.
- To ensure that the economic strengths of each country are used to build relations and eliminate competition where possible.
- BRICS is becoming a new and promising diplomatic and political group with goals that go far beyond the original goal.
- Initially, it was only expected to solve global financial problems and change the way institutions worked.

10.5.4 EU – European Union

European Union is the most integrated trade block in the world and formed in the year 1951. It has built a single Europe-wide market and also launched Euro as a single currency for regional trading. European Union goods exports to the global market worth USD 5887 billion and imports worth USD 5785 billion during the year 2017.

EU consists of 28 member countries which are Austria, Belgium, Bulgaria, Denmark, Finland, Germany, France, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Romania, Spain, Sweden, United Kingdom, Cyprus, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia. European Union comprises five EU institutions namely European Parliament, Council of the EU, European Commission, Court of Justice and Court of Auditors.

Objectives of European Union

The European Union has grown from an economy-only organisation to one with a more holistic mission. Article 3 of the Lisbon Treaty fully encapsulates the organisation's goals.

- Promote peace and well-being among the citizens
- Offer freedom, security and justice without internal borders
- Work towards the sustainable development of Europe while promoting equality and social justice
- Establish an economic union with Euro as the currency
- Contribute to the sustainable development, peace, and security of the planet

The EU also aims to combat social exclusion and discrimination, respecting the rich cultural and linguistic diversity. Promoting scientific and technological progress in the organisation is also a priority, directly influencing the region's sustainable development.

For the years 2019-2024, the European Council has laid down a new strategic agenda, highlighting the following four priorities:

- Protecting citizens and freedoms
- Developing a strong and vibrant economic base
- Building a climate-neutral, green, fair and social Europe
- Promoting European interests and values on the global stage

10.5.5 NAFTA – North America Free Trade Agreement

NAFTA was established on 1st January 1994 and comprises three giant member countries which are Canada, United States and Mexico. USA and Canada provide highly industrialized environment for manufacturing & services growth while Mexico provides cheaper resources. NAFTA is responsible to eliminate trade barriers among its member countries, promote a free trade environment and to increase investment opportunities. NAFTA goods exports stood at USD 2376 billion and imports stood at USD 3262 billion during the year 2017. United States is the largest trading country among NAFTA countries.

Functions of NAFTA

The NAFTA agreement has six main functions to achieve along with other rights. According to **Article 102**, the following are the NAFTA objectives. Let us look at them:

- Eliminating trade barriers and enabling the cross-boundary transfer of products and services.
- Promoting fair competition within the area.
- Increasing investment opportunities across the country's borders.
- Providing enough protection and enforcement of intellectual property rights.
- Creating effective procedures for implementing the agreement and for trade disputes.
- Developing trilateral, multilateral, and regional relations to expand trade benefits

10.5.6 CIS – Commonwealth of Independent States:

The **Commonwealth of Independent States [CIS]** is an association that coordinates to facilitate the free movement of goods, services, labour force, and capital between its member states. It was established in 1991, and 12 countries are its member. It was formed post the dissolution of the Soviet Union. The Commonwealth of Independent States [CIS] functions based on the Charter that was adopted Council of Heads of State on the 22nd of January 1993. CIS group was founded in the year 1991 and it is a group of 12 member countries including Azerbaijan, Armenia, Russia, Ukraine, Kazakhstan, Belarus, Turkmenistan, Uzbekistan, Georgia, Moldova, Kyrgyzstan and Tajikistan. According to CIS countries trade data, the contribution of CIS nations in the world's exports was 2.6% in 2016, which declined from 2015's 3%. And in world's imports, countries of CIS region contributed 2% in both the years.

Commonwealth of Independent States [CIS] Objectives:

Commonwealth of Independent States [CIS] encourages economic, political, and military cooperation among the member states and is defined as the regional intergovernmental organization in Eastern Europe and Asia

1. Supporting economic and social developments in the member countries with a common economic space.
2. Ensure human rights and fundamental freedom as per the principles recognized universally.
3. Ensure international peace and security to facilitate cooperation between the member states.
4. And peacefully resolve disputes and conflicts between the member states.

10.5.7 COMESA – Common Market for Eastern and Southern Africa

COMESA exists as an organization of independent sovereign states that have agreed to cooperate in developing the regional or global trade. It is an economic union of southern and eastern African countries. It consists of 19 member countries such as Burundi, Comoros, DR Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe. COMESA exports recorded USD 65.93 billion and imports recorded USD 142.29 billion during the year 2016. Egypt is the largest trader among COMESA countries.

Objectives of COMESA:

(a) The need to create and maintain: full free trade area guaranteeing the free movement of goods and services produced within COMESA and the removal of all tariffs and non-tariff barriers;

(b) A customs union under which goods and services imported from non-COMESA countries will attract an agreed single tariff (Common External Tariff) in all COMESA Member States;

(c) Free movement of capital and investment supported by the adoption of a common investment area so as to create a more favourable investment climate for the COMESA region;

(d) Gradual establishment of a payment union based on the COMESA Clearing House and the eventual establishment of a common monetary union with a common currency; and (e) Gradual Relaxation and Eventual Elimination of Visa Requirements leading to the Free Movement of Persons, Labour, Service, Right of Establishment and Residence.

10.5.8 SAARC – South Asian Association for Regional Cooperation

SAARC provides a platform for the people of South Asian countries to work together in a spirit of trust and understanding. It was founded on 8th December 1985 and its member states include Afghanistan, Bangladesh, Bhutan, India, Nepal, Maldives, Pakistan and Sri Lanka. SAARC exports of goods to the world worth USD 330 billion and imports worth USD 481 billion in the year 2016. India is the biggest trading country in both imports and exports among SAARC members. SAARC organize summits annually and the country hosting the summit holds the chair of the association. The SAARC’s headquarters and secretariat are located in Kathmandu, Nepal.

SAARC Objectives

- To advance the welfare of South Asians and to enhance their standard of living;
- To promote the region’s economic growth, social advancement, and cultural development while giving everyone the chance to live in dignity and reach their full potential;
- To encourage and reinforce South Asian countries’ collective self-reliance;
- To foster understanding, trust, and respect for one another’s concerns;
- To encourage active cooperation and mutual aid in the realms of economics, society, culture, technology, and science;
- To improve collaboration with other emerging nations;
- To improve their mutual cooperation in international platforms on issues of common interest; and
- To collaborate with regional and global groups that share similar goals.

SAARC Functions

- To raise the standard of living of South Asians in order to improve their well-being.

- Everybody is able to live their lives to the fullest extent of their potential and dignity, contributing to social, cultural, and economic progress.
- To advance and reinforce the idea of self-sufficiency among South Asian nations.
- To support the member nations in their efforts to coordinate and collaborate with other developing nations.

SAARC Principles

- Adherence to the values of sovereign equality, territorial integrity, political independence, non-intervention in the internal affairs of other States, and mutual benefit.
- Bilateral and multilateral cooperation must still exist, but this new form of cooperation must enhance it.
- Such cooperation must not conflict with duties under bilateral and multilateral agreements.

10.5.9 MERCOSUR:

MERCOSUR stands for Mercado Comun del Cono Sur which means Southern Common Market and it was established on 26th March 1991. It is tariff union of South American countries covering the market of Brazil, Argentina, Venezuela, Paraguay and Uruguay. Its associate members include Bolivia, Chile, Colombia, Ecuador and Peru. Its main goals are to accelerate sustained economic development. MERCOSUR is one of the fastest growing trading blocks in the world. Spanish and Portuguese are the major languages spoken in this region. MERCOSUR global exports worth USD 292 billion and imports worth USD 237 billion during the year 2017.

Mercosur's main objective is to increase the efficiency and competitiveness of the all member economies by opening markets, promoting economic development in the framework of a globalized world, improving infrastructure and communications, making better use of available resources, preserving the environment, generating industrial complementation and coordinating macroeconomic polices. Achieving a common external tariff is one of the main goals of the block.

10.5.10 IOR-ARC – Indian Ocean Rim Association for Regional Cooperation

IOR-ARC comprises 21 member countries such as Australia, Bangladesh, Comoros, India, Indonesia, Iran, Kenya, Madagascar, Malaysia, Mauritius, Mozambique, Oman, Seychelles, Somalia, Singapore, South Africa, Sri Lanka, Tanzania, Thailand, UAE and Yemen. Initially IOR ARC consisted of 7 countries only but it has expanded to include other countries as well. It aims to promote sustainable growth and development of its members. IOR-ARC exports worth USD 1875 billion and imports worth USD 1847 billion during 2016.

Objectives & Priority Areas of Cooperation:

The objectives of IORA are as follows:[6]

1. To promote sustainable growth and balanced development of the region and member states
2. To focus on those areas of economic cooperation which provide maximum opportunities for development, shared interest and mutual benefits

3. To promote liberalisation, remove impediments and lower barriers towards a freer and enhanced flow of goods, services, investment, and technology within the Indian Ocean rim.

Indian Ocean Rim Association (IORA) has identified six priority areas, namely:

1. maritime security,
2. trade and investment facilitation,
3. fisheries management,
4. disaster risk reduction,
5. academic and scientific cooperation and
6. Tourism promotion and cultural exchanges.

10.6 SUMMARY

Regional trade blocs are groups of countries that have formed a regional economic alliance in order to promote trade and economic cooperation within the region. Regional trade blocs are often formed as a way to reduce barriers to trade and to promote economic integration among member countries. There are many different types of regional trade blocs, and they vary in terms of the level of economic integration and cooperation that they promote. Some regional trade blocs are relatively loose arrangements that focus on reducing tariffs and other trade barriers, while others are more comprehensive and involve the creation of a single market or customs union among member countries.

10.7 KEYWORDS

Regional trade groups
economic union
political union
political union free trade area
customs union
common market

10.8 SELF- ASSESSMENT QUESTIONS

1. Define the role and importance of regional trade groupings in International business
2. Explain the types or stages of regional trade groupings
3. Explain the advantages and disadvantages of regional trade groupings
4. Narrate the objectives and functions of SAARC and EU
5. Briefly explain the objectives and functions of NAFTA and BRICS.

10.9 FURTHER READINGS

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LESSION - 11
ROLE OF INTERNATIONAL ORGANIZATIONS IN INTERNATIONAL BUSINESS

OBJECTIVES

- To know about various international organisation in world.
- To understand the role of international organisations in international trade
- To Know the role and principles of WTO in international Business
- To study the goals and functions of world Bank
- To Evaluate the roles and functions of IMF in international trade

STRUCTURE

11.1 Introduction to International organisations
11.2 Role of international organisations in regulating trade between countries
11.3 Role and key objectives of (World Trade Organisation) WTO.
11.4 Key functions of WTO
11.5 Principles of WTO with respect to trading system.
11.6 WTO and Sustainable goals
11.7 Role of World Bank in International Trade
11.8 Principles of International Monetary Fund (IMF)
11.9 Role of IMF
11.10 Functions of IMF
11.11 Summary
11.12 Key words
11.13Self Assessment Questions
11.14 Further Readings

11.1 INTRODUCTION

In an increasingly interconnected and interdependent world, some issues are too big for countries to handle on their own. Countries need to work together, and they do so in part through international organizations that facilitate cooperation and encourage diplomatic solutions to global trade.

In an increasingly globalized world, international organizations play an important role in importing and exporting. Their functions include maintaining standards to ensure safety, helping developing countries achieve economic security and establishing norms regarding how countries make trade agreements and resolve conflicts.

11.2 ROLE OF INTERNATIONAL ORGANISATIONS IN REGULATING TRADE BETWEEN COUNTRIES

With the increasing forces of globalisation the need for trade regulation in an unbiased and objective manner increases. This role has been assumed by World Trade Organisation (WTO) and its functions include administration of trade agreements, serving as a forum for trade negotiations, dealing with trade disputes between its members, and monitoring policies of its members related to trade.

Established in January 1, 1995, WTO comprises 159 members and it is based in Geneva, Switzerland (Annual Report, 2013). There are contradicting assessments of WTO performance in terms of regulating trade between counties in an effective manner. You can read more scope, contribution and criticism related to WTO here.

On one hand, WTO has been praised for such positive impacts as stimulating economic growth and increasing the level of employment, encouraging good governance practices, contributing to peace and stability and settling trade disputes amongst its members (Ahern and Fergusson, 2010).

On the other hand, WTO critics argue that the organisation has made a counter-productive impact on development of a range of its members, and it also has been blamed for neglecting environmental issues. Moreover, WTO has been criticised on the grounds of political bias for serving as an instrument at the hands of its few hegemonic members.

Moreover, there are other international organisations which are parts of United Nations Organisations (UN) such as World Bank, and International Monetary Fund (IMF), that have certain impacts in international trade practices.

UN in general, and its Economic and Social Council in particular can be specified as another international organisation that does have impact on trade regulation between countries. Comprising 54 members for three-year terms, the Economic and Social Council aims to promote international cooperation in order to achieve economic and social development.

Millennium Development Goals is one of the most noteworthy economic initiatives proposed by the UN Economic and Social Council. The initiative involves decreasing the numbers of people that have income of less than USD 1 per day by 50 percent, assisting in provision of primary education for all children around the globe, and decreasing the number of people with no access to sanitation and drinking water by twice by the year of 2015 (Leisinger et al., 2010).

However, the extent of effective achievement of this aim is impacted by a set of factors that include lack of capacity, influence of politics, disagreement amongst members in terms of the choice of tools to deal with economic issues and others.

IMF belongs to UN system and it aims to achieve effective monetary cooperation in international level and reduce global poverty through its programs and initiatives. IMF has certain impact in trade between countries, although this impact is indirect and insubstantial. Specifically, reduction on the level of global poverty according to IMF aims and objectives can facilitate opening of new segments in the global marketplace and can cause new businesses to join the global marketplace.

11.3 ROLE OF (WORLD TRADE ORGANISATION) WTO IN INTERNATIONAL BUSINESS

International trade refers to the sale and purchase of goods and services across international borders. This trade is carried out through a contract between two or more parties, which is regulated by the World Trade Organisation (WTO). The WTO is the only international organisation that regulates rules and regulations for trade carried out by different

nations. The main purpose of the WTO is to 'open trade for all' so that every nation can benefit from it.

Various nations exercise their supreme economic sovereignty while regulating the import and export of goods and services in and out of their territory. Some of them believe the use of foreign goods in their territory is an infringement of their territorial integrity or an incursion of their uniqueness. This results in various kinds of "trade barriers" between the countries, which consequently leads to difficulties in international trade. Moreover, it led to the unavailability and scarcity of certain commodities in the state markets. This necessitated the formation of international organisations in order to remove trade barriers and ease international trade. As a result, firstly, in 1947, the General Agreement on Trade and Tariffs (GATT) came into existence, and later it was replaced with the World Trade Organisation (WTO), which is playing a significant role in promoting international trade at present.

WTO plays a very indispensable role in promoting, regulating or supervising international trade. Its very purpose, since its inception, has been to encourage progressive liberalisation in trade by removing different kinds of trade barriers and opening up the markets, which is crucial for overall economic development and well-being. Its main function is the negotiation of trade rules or agreements, which provides the countries with an opportunity to show their commitment to liberalising international trade. WTO's trading principles, like transparency in trade rules, non-discrimination, etc., further provide it with a robust structure to fulfil its commitments to promoting international trade. It created an opportunity for even developing countries to make their markets accessible to other countries and achieve economic growth and development. The WTO has been successful in establishing many trade agreements that liberalise trade between countries. Moreover, its Dispute Settlement Body has proven effective in many trade-related disputes.

11.3.1 Key objectives of WTO

The welfare of the people

The main objective of the WTO is to improve the lives of people by raising their living standards, creating jobs, raising their incomes, or expanding the trade of goods and services globally. It helps developing or under-developed countries enhance their trade capacity so that they can achieve economic growth and stability.

Negotiating trade rules

WTO strives to remove trade barriers or any other obstacles from the way of the progressive international trading system. These negotiations help the countries open their markets for trade. But at the same time, some trade barriers were maintained in order to protect the interests of consumers or the environment, etc.

Supervising WTO agreements

WTO agreements provide the rules for conducting international trade and commerce. It binds the signatory countries to limit their trade policies in accordance with these agreement provisions. These agreements strive to protect and help producers of goods and services, importers or exporters in conducting their businesses, and others involved in these trading activities.

Ensuring open trade

The main objective behind the emergence of the WTO is to maintain the free flow of trade as much as possible without any undesirable consequences like unfair competition, hegemony in a certain variety of goods or services, biassed trade policies, etc. WTO helps the inclusion of developing countries in the international trading system and helps them to achieve economic growth and ensure full employment. It oversees the trade rules and policies governing international trade and ensures that they are transparent and easily predictable.

Dispute settlement

In conducting international trade, several trade disputes also arise due to the conflicting interests of one nation and those of another nation. These disputes have been settled or negotiated by the WTO, which also involves the interpretation of WTO agreements. The WTO, as a neutral body, settles these disputes in accordance with the Dispute Settlement process provided in WTO agreements.

11.4. KEY FUNCTIONS OF THE WTO

Implementation of the WTO agreements

WTO ensures that governments of every member country make their trade policies in accordance with the WTO agreements. WTO councils and committees ensure that WTO agreements are properly implemented and all other requirements have been satisfied. To monitor the status of such implementation, all members have to undergo a periodic review of their trade policies.

Trade negotiations

This is one of the most important functions of the WTO. WTO agreements include goods, services, and intellectual property. These agreements are not fixed, they may be negotiated according to the situation of one or more countries and their commitments to open trade markets. The WTO provides exceptions to various principles of trade enshrined in WTO agreements. New rules or agreements are also added from time to time.

Settling of disputes

Settling disputes arising between countries or with respect to trade is essential for the system of international trade to run smoothly. The process for settling such disputes is provided in WTO agreements. So, if any country thinks that its rights under any agreement have been infringed, it can bring such disputes to the WTO. The WTO appoints independent experts to resolve its disputes based on the interpretation of provisions of the WTO agreements and other relevant factors.

Help countries build trade capacity

The WTO empowers developing countries to boost their trading capacity and help them develop the skills and infrastructure required to expand their trade. It conducts various missions or courses, especially focused on developing countries. Even in WTO agreements, special provisions were provided for developing countries.

Enhancing cooperation between states and non-state actors

WTO remains in constant touch with various non-governmental organisations (NGOs), media, parliamentary members, other international organisations, and the general public in order to get their opinions on various aspects of WTO and ongoing negotiations and maintain their cooperation in the international trading system.

Conducting economic research

The WTO conducts research in the field of trade and other economic activities and also collects and disseminates various data and information in support of its activities.

11.5 PRINCIPLES OF WTO WITH RESPECT TO THE TRADING SYSTEM

No discrimination in trade

According to the WTO agreements, countries cannot discriminate between two countries as trading partners. They cannot grant some countries special favours in trade by lowering rates of customs duty or taxes, etc. Every WTO member should be treated likewise. This principle is known as Most-Favoured Nation (MFN) treatment. It means that if one nation lowers its trade barriers or opens its market, it has to do the same for all other countries, which are its trading partners. However, there are some exceptions to this general principle that are allowed. For example, a government can set up a free trade agreement for certain goods to be traded with certain countries.

Free trade

The WTO conducts its activities on the principle of "free trade" or "progressive liberalisation". It encourages nations to open their markets, lower their trade barriers, or restrict customs duties, import bans, or quotas. Since its inception, it has continuously worked on this principle through various rounds of negotiations and agreements, persuading countries by highlighting the benefits of opening markets for international trade.

Transparency in the trading system

It is the duty of the WTO to ensure that the trade policies and rules of each member country are transparent and easily predictable. These policies should not be subject to too many recurring changes, they should be stable enough to avoid any inconsistencies in their understanding by other countries. By discouraging quotas or import limits, which can lead to red-tapism or unfair play, one can maintain stability or predictability.

Fair competition

The WTO is dedicated to establishing open and fair competition in the international trading system. As it is based on the principle of non-discrimination in trade, it is successfully establishing secure conditions for fair and undistorted competition.

Economic development and reform

WTO helps in the development of nations. It has provided special provisions for developing nations, allowing them certain trade concessions. Certain agreements by the WTO provide developing countries with a 'period of transition' so that they may easily adjust to new situations.

Building trade capacity of developing countries by the WTO

The WTO plays an important role in uplifting developing countries, which make up three-fourths of its total membership. Through various assistance programmes or partnerships, the WTO tries to increase the capability of developing nations to carry out trade and business so that they can present themselves in the global market. Various training courses and programmes were conducted jointly with other international organisations, in order to build their trade capacities. This guidance is provided on any subject, whether related to participation in the WTO, help in negotiations, implementation of its commitments, etc. The least developed countries among them were getting special attention and help with trade/ tariff data related to their export interests and participation in the WTO.

Committee on Trade and Development (CTD)

It is the main body in the WTO responsible for the coordination of work on development. It works on a variety of issues related to trade in developing countries, like the implementation of WTO agreements, technical assistance, and increased participation. It approves, monitors, and provides guidance for technical assistance programmes conducted by the WTO. The Doha Declaration mandates it to review all special and differential provisions for developing countries in order to strengthen them and make them more suitable and effective for them.

Aid for Trade initiative

The Aid for Trade initiative was launched by the WTO in December 2005 at the Sixth WTO Ministerial Conference held in Hong Kong, China. It works on the basis of a biennial work programme. It was designed to help developing nations build trade capacity by opening opportunities for them to enhance their infrastructure and improve their ability to earn benefits. The theme for the 2020-2022 Aid for Trade Work Programme is "Empowering Connected, Sustainable Trade." This work programme is dedicated to carrying out an analysis of the opportunities offered by digital connectivity and sustainability. More than 400 billion dollars has been disbursed until now for supporting the Aid for Trade projects.

Enhanced Integrated Framework (EIF)

The Enhanced Integrated Framework is the main mechanism through which less developed economies can access Aid for Trade projects. It bridges the gap between demand and supply for the Aid for Trade programmes and mainstreams them into their national development plans. It provides a way for the least developed countries (LDCs) to set their priorities regarding trade-related assistance and capacity building and to channel their demands through the Aid for Trade process through the EIF process for accessing resources. The EIF Trust Fund provides funding to LDCs and enables them to take advantage of the benefits of Aid for Trade.

Standards and Trade Development Facility (STDF)

The Standards and Trade Development Facility (STDF) is the joint brainchild of the heads of FAO, OIE, WHO, the World Bank, and the WTO and was launched at the Doha Ministerial Conference in November 2001. It plays a key role in helping developing economies meet international standards for food security, animal and plant health, and other trade requirements on the way to accessing global markets. It complements the Aid for Trade initiative through other projects and monitoring of aid flows. The STDF Trust Fund, supervised by the STDF Secretariat and totaling over 50 million dollars, has been supporting many projects in Africa, Asia-Pacific, Latin America, etc.

Assistance and training

The WTO ensures that each country is able to take full advantage of the multilateral trading system and, therefore, organises many technical assistance programmes throughout the year. Under the WTO Secretariat, these assistance programmes are coordinated by the Institute for Training and Technical Cooperation (ITTC) on the basis of training and assistance plans. The Committee on Trade and Development supervises all these activities. These training and technical assistance courses were made in accordance with each country's specific needs and requirements.

WTO's dispute settlement mechanism

The dispute settlement mechanism provided by the WTO is very essential for the smooth functioning of the multilateral trading system and the effectiveness of its rules and agreements. It contributes to maintaining stability in the global economy.
Any dispute brought to the WTO has to go through various stages of dispute resolution. There are two ways of dispute resolution:

1. Mutual agreement,
2. Adjudication

11.6 WTO AND THE SUSTAINABLE DEVELOPMENT GOALS (SDGS)

In addition to strengthening and liberalising international trade, the WTO also plays a significant role in the achievement of the UN's Agenda for Sustainable Development Goals (SDGs) by 2030 in the areas related to poverty alleviation, food security, health, education, the environment, etc. The SDGs recognise the contribution of trade and the WTO in achieving these goals, as the WTO, by implementing certain trade reforms and agreements, is helping the countries achieve economic growth and development, which are part of the SDGs. The WTO is monitored on an annual basis by the UN's High-Level Political Forum (HLPF) on its efforts to achieve SDGs related to trade.

No poverty
Opening markets and trade can grow more opportunities for low-income countries and can uplift their living standards through increased competition, better prices of goods and services, and more choices for consumers.

Zero hunger
The WTO also plays an important role in achieving food security through its reformed trade policies for agricultural goods. By eliminating subsidies on agricultural produce, fairer prices in competitive markets can be ensured.

Good health and well-being
WTO also plays a significant role in ensuring affordable medicines to all countries, especially the least developed nations.

Decent work and economic growth
By increasing trade capacities and creating various economic opportunities for the countries that were less developed, it ensures good economic growth and a decent work environment for them.

Reduced inequalities
WTO seeks to bridge the gap between developing and developed nations through various initiatives based on the principle of "Special and Differential Treatment for Developing Countries," which especially focuses on developing nations taking into account their capacity constraints.

11.7. ROLE OF WORLD BANK IN INTERNATIONAL BUSINESS/ TRADE

The origins of the World Bank (WB) are conventionally dated back to the Bretton Woods conference in 1944 which saw the birth of both the WB and the International Monetary Fund (IMF) as UN specialised agencies with the aim of promoting international economic cooperation and development. However, the assumption that the WB was created at the Bretton Woods conference is only partially true. The only body created at that time was the International Bank for Reconstruction and Development (IBRD). The World Bank is an international financial institution formed by the International Bank for Reconstruction and Development and the International Development Association (IDA). It provides, mostly through the IBRD, loans to applicant countries with the aim of boosting local development and fighting poverty. The World Bank is in turn a member of the World Bank Group (WBG). This group is formed by five organisations engaged in the fight against poverty and social inequality, namely the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA) and the International Centre for Settlement of Investment Disputes (ICSID). The World Bank Group has observer status at the United Nations Development Group.

- The World Bank is an international organization that provides financing, advice, and research to developing nations to help advance their economies.
- The World Bank and International Monetary Fund (IMF)—founded simultaneously under the Bretton Woods Agreement—both seek to serve international governments.
- The World Bank has expanded to become known as the World Bank Group with five cooperative organizations, sometimes known as the World Banks.
- The World Bank Group offers a multitude of proprietary financial assistance, products, and solutions for international governments, as well as a range of research-based thought leadership for the global economy at large.
- The World Bank's Human Capital Project seeks to help nations invest in and develop their human capital to produce a better society and economy.

The World Bank Group (WBG) helps developing countries improve their access to world markets and enhance their participation in the global trading system. Trade is an engine of growth that creates better jobs, reduces poverty, and increases economic opportunity. Recent research shows that trade liberalization increases economic growth by an average of 1.0 to 1.5 percentage points, resulting in 10 to 20 percent higher income after a decade. Since 1990, trade has increased incomes by 24 percent globally and by 50 percent for the poorest 40 percent of the population. Economic growth underpinned by better trade practices has lifted more than 1 billion people out of poverty since 1990.

In developing countries, access to global markets is often hindered by anti-competitive business practices, regulation that is unfavourable to business growth and investment, and inadequate ports, roads and other infrastructure. Even a country with liberal and transparent trade policy suffers if its markets are not connected. Many of the world's poorest people live in places that are landlocked, remote or otherwise ill-served by international trade links. The WBG helps its client countries overcome these obstacles and more fully reap the benefits of global markets.

Still, we must recognize that not everyone is experiencing the benefits of globalization. Most global poverty reduction has been concentrated in Asian countries, principally in China, while other regions continue to experience high inequality and poverty. Powerful protectionist forces have begun to challenge the global community's commitment to open trade; many in advanced economies blame trade for job losses as manufacturing and some services shift to lower-cost destinations. Disruptions to global supply chains and rising shipping costs caused by the COVID-19 pandemic have also put the economic recovery at risk, adding to calls for reshoring production of vital goods, especially medical products and semiconductors. Disruptions to global food and fertilizer markets caused by the war in Ukraine and sanctions on Russia are expected to significantly worsen food and nutrition insecurity in developing countries.

Promoting international trade and advancing sustainable economic development are not mutually exclusive and can be mutually reinforcing. The damage wrought by climate change highlights the urgent need for adjustments in trade: The extraction and processing of natural resources account for more than 90 percent of biodiversity loss and water stress and half of greenhouse-gas emissions. Yet with the right policies, trade can play a central part in efforts to adapt to climate change and mitigate its impact: It can foster the spread of Environmental Goods and Services such as solar panels and recycling to help reduce emissions and improve biodiversity, and it can facilitate the transfer of climate-friendly technologies. As countries adopt policies to meet their global carbon commitments, their trading partners can develop areas of "carbon competitiveness" through reduced carbon intensity of production and seize new opportunities in green growth. This will lead to more sustainable supply chains and diversification away from carbon-intensive sectors. Nevertheless, a challenge will be to combine sustainability standards with more and open trade. Developing country participation will be needed to ensure that new rules are feasible for them.

As the largest multilateral provider of Aid for Trade, the WBG is advancing policies that help developing countries—and disadvantaged groups within them—benefit from the opportunities that come with trade and technological change and to ensure that trade-driven growth is green, resilient and inclusive.

11.8 Principal of the World Bank Group's work in trade:

Trade Policy and Integration: Analysis and policy advice to help countries eliminate unnecessary non-tariff measures, or NTMs, modernise services regulations and trade, address the poverty and labour impacts of trade policies and shocks, and support global and regional integration, including free trade agreement negotiations and World Trade Organization accession and participation.

Trade Performance: Help for governments in designing and implementing policies to maximise their trade competitiveness in both goods and services; assistance in creating comprehensive policy frameworks that shape individual firms' capacities and incentives to import and export; and helping governments to reap the benefits of openness to trade and to manage both adjustment costs and external shocks.

Competition Policies: Eliminating anti-competitive market regulations; strengthening antitrust rules; promoting pro competition sector policies to discourage monopolies of state-owned enterprises.

Trade Facilitation and Logistics: Strengthening trade corridors, supply chains and trade logistics; modernising border management; enhancing connectivity between firms, markets and consumers.

Four priority themes govern the 2011 WBG trade strategy: trade competitiveness and diversification; trade facilitation, transport logistics and trade finance; support for market access and international trade cooperation; and managing shocks and promoting greater inclusion.

The WB strongly supports the creation of a sound multilateral trade system and its purpose is to offer expertise and support to Least Developed Countries and developing countries.

EU-WGB cooperation in the area of international trade does not yet match the level of ambition achieved for development cooperation.

The WBG's impact on EU trade policy is limited to specific issues and can be seen as marginal. Cooperation with the EU is based on four pillars: aid coordination; financing relationship; policy dialogue; global public goods.

To fund much of this work, the **World Bank Group has five main trade related trust funds,** two of which receive financial contributions from the EU:

The Multi-Donor Trust Fund for Trade and Development (MDTFTD2) is the largest source of donor funds supporting analytical trade work across the WBG. The WBG has received USD 34.5 million in pledges to the MDTF-TD2 over three years.

The Trade Facilitation Support Programme (TFSP), supported by the European Commission, is a multi-donor platform launched in June 2014 that provides developing countries with rapid-response technical assistance to help them align with the World Trade Organization's December 2013 Trade Facilitation Agreement. To date, 45 countries have sought support from the USD 36 million trust fund.

The Trade Facilitation Facility (TFF), which closed in July 2015, supported improvements in customs and other trade facilitation systems that help developing countries reduce trade costs and improve competitiveness. As of March 2015, 76 projects with an allocation of USD 49.8 million had been approved. Eighty percent of these benefit African countries.31

The Enhanced Integrated Framework (EIF) trust fund, also supported by the European Commission, supports WBG work as part of the global EIF partnership's efforts to help LDCs tackle constraints to trade. It funds capacity-building in LDCs, diagnostics that identify key trade constraints, and the implementation of technical assistance projects. The trust fund has received USD 4.3 million and currently provides trade-related support to 16 LDCs.

The Transparency in Trade (TNT) trust fund, which is an ongoing partnership between the ITC (Geneva), UNCTAD and the WBG, with active support from the AfDB. Its goal is to collect and make data on non-tariff measures and services trade policies.

The WGB strongly advocates trade liberalisation as a way of achieving higher economic growth and sustainable development. It has created a range of analytical instruments aimed at identifying major restraints on free trade

In order to promote trade liberalisation, the WBG has also created a range of analytical instruments aimed at identifying major restraints on free trade in each member state's market. Of these, the four most important are:

Regulatory Assessment on Services Trade and Investment (RASTI) which helps 'policy makers assess regulations consistently, streamline the regulatory framework in services to improve efficiency, and set up a process for introducing new regulations'.

Streamlining Non-Tariff Measures: A Toolkit for Policy Makers, which helps 'policy makers in in reviewing and improving 'non-tariff measures' (NTMs), that is, policies other than tariffs that affect international trade'.

Trade competitiveness diagnostic toolkit, which aims at assessing the competitiveness of a country's exports through a range of tools and indicators that 'analyse trade performance in terms of growth, orientation, diversification, quality, and survival, as well as quantitative and qualitative approaches to analyse the market and supply-side factors that determine competitiveness'.

Toolkit for the analysis of current account imbalances which 'explores current account determinants, external sustainability, cyclical versus structural factors, and the role of the financial account' in international trade.

These instruments provide developing countries with the appropriate tools to reform their markets in order to become proactive actors in international trade and to raise the interest of foreign investors.

11.9 ROLE OF INTERNATIONAL MONETARY FUND (IMF) IN INTERNATIONAL TRADE/ BUSINESS

The International Monetary Fund, founded in 1944, is a voluntary financial institution with a membership of 184 countries. It fosters among these countries cooperative monetary

policies that stabilize the exchange of one national currency for another. It thereby encourages international trade. The IMF provides a mechanism in which each member country can cooperate with the others to promote its domestic economic prosperity and that of the entire membership. The IMF maintains an extensive database of statistics on members' economies and on the world economy as a whole, which it shares with every member country. At the request of a member, it extends technical assistance in financial, fiscal, and economic matters. If persuaded that a member country, behind in payments to other countries, will implement reform policies, the IMF will lend money to tide that member over until the reforms take effect.

The International Monetary Fund (IMF) works to achieve sustainable growth and prosperity for all of its 190 member countries. It does so by supporting economic policies that promote financial stability and monetary cooperation, which are essential to increase productivity, job creation, and economic well-being. The IMF is governed by and accountable to its member countries.

The IMF has three critical missions: furthering international monetary cooperation, encouraging the expansion of trade and economic growth, and discouraging policies that would harm prosperity. To fulfill these missions, IMF member countries work collaboratively with each other and with other international bodies.

A core responsibility of the IMF is monitoring the economic and financial policies of member countries and providing them with policy advice, an activity known as *surveillance*. As part of this process, which also takes place at the global and regional levels, the IMF identifies potential risks and recommends appropriate policy adjustments to sustain economic growth and promote financial stability.

The purposes of IMF are clearly expressed in Article I of its constitution, the Articles of Agreement:

- To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
- To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
- To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
- To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.
- To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.
- In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

Economic observation and monitoring: The IMF prepares reports on the economies of its member nations and identifies potential danger zones (such as imbalanced economies with significant current account deficits or excessive debt levels).

Loans to underdeveloped countries: $300 billion in loanable funds are available from the IMF for loans to nations experiencing financial crises. This is contributed by the member nations, each of which made an initial deposit. The IMF may be willing to provide loans as a component of a financial realignment in times of financial or economic crisis.

Dependent loans/structural transformation: The IMF often requires that certain requirements be completed before granting loans; Price controls are removed, deficit reduction measures are implemented, tightening monetary policy is used to reduce inflation, and tariff barriers are removed to promote free trade.

Technical aid and economic education: The IMF produces many reports and publications to promote local economies.

11.10 FUNCTIONS OF IMF

The IMF employs three main functions – surveillance, financial assistance, and technical assistance – to promote the stability of the international monetary and financial system.

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

Financial Assistance: The IMF lends to its member countries facing balance of payments problems in order to facilitate the adjustment process and restore member countries' economic growth and stability through various loan instruments or "facilities". An IMF loan is usually provided under an "arrangement," requiring a borrowing country to undertake the specific policies and measures to resolve its balance of payments problem as specified in a "Letter of Intent." Most IMF loans are primarily financed by its member countries through payments of quotas. Thus, the IMF's lending capacity is mainly determined by the total amount of quotas. Nevertheless, if necessary, the IMF may borrow from a number of its financially strongest member countries through the New Arrangements to Borrow (NAB) or the General Arrangements to Borrow (GAB) .

When its member countries experience balance of payments (BOP) difficulties, either through capital account or current account crises, the IMF can make loans designed to help them stabilize their international payments situation and adopt policy changes sufficient to reverse their situation and overcome their problems. In some cases, the IMF makes short-term loans to help prevent countries' economies from spiraling into financial crisis and to facilitate renewed inflows of private sector capital. Many financial crises in developing countries in recent years were the result of a lack of confidence by the international financial markets and the "sudden stop" or reversal of capital inflows to developing countries which

often occurs at the outset of a crisis. In other cases, the IMF makes loans to help countries deal with BOP crises but the loan repayment period is longer and the conditionality includes problems which are more deeply rooted and require more time than is usually possible in the IMF's usual timeline.

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

11.11 SUMMARY

In an increasingly globalized world, international organizations play an important role in importing and exporting. Their functions include maintaining standards to ensure safety, helping developing countries achieve economic security and establishing norms regarding how countries make trade agreements and resolve conflicts. Whether you're new to international trade or a seasoned veteran, understanding the part that these organizations play is key to clear communication and compliance with both import and export regulations.

11.12 KEY WORDS

World Trade organisation
International Monetary Fund
World Bank
Imports and exports
International trade
Borrowings
Trade restrictions

11.13 SELF ASSESSMENT QUESTIONS

1. Briefly explain the role of International Organisations in International Business
2. Explain the Functions and principle of International Monetary Fund.
3. Explain the role of World Trade Organisation in international Business
4. Explain Objectives and Function of World bank in Promoting International Trade

11.14 FURTHER READINGS

1. V K Bhalla, International Business , Anmol Publications,(India).
2. Anant K Sundaram and J Stewart Black , The International Business Environment , PHI New Delhi, Estern Economy Edition (2012).
3. Daniels and Sullivan, International Business, Pearson publication,(2007)

Dr. N. PRASANNA KUMAR

LESSON- 12
MULTILATERAL TRADE AGREEMENT

OBJECTIVES

- To Understand the importance of Multilateral and Bilateral Trade Agreements
- To know the various types of trade agreements.
- To study the some examples of trade agreements in the world
- To study the Advantages and disadvantages of trade agreements
- To Evaluate the role of trade agreements in international Business
- To study the important trade agreements of India

STRUCTURE

12.1 Introduction to Multilateral and Bilateral Trade Agreements
12.2 Meaning of Multilateral and Bilateral Trade Agreements
12.3 Examples of trade agreements in the world
12.4 Advantages and disadvantages of trade agreements
12.5 Role of trade agreements in international Business
12.6 important trade agreements of India
12.7 Summary
12.8 Keywords
12.9 Self- Assessment questions
12.10 Further Readings

12.1 INTRODUCTION

A multilateral agreement is a trade agreement formed between three or more countries that aim to break down trade barriers to simplify importing and exporting. A multilateral agreement is a trade agreement established between three or more countries with the intention of reducing barriers to trade, such as tariffs, subsidies, and embargoes, that limit a nation's ability to import or export goods. They are considered the best method of encouraging a truly global economy that opens markets to small and large countries on an equitable basis.

The term multilateral trade negotiations (MTN) initially applied to negotiations between General Agreement on Tariffs and Trade (GATT) member nations conducted under the auspices of the GATT and aimed at reducing tariff and nontariff trade barriers. In 1995 the World Trade Organization (WTO) replaced the GATT as the administrative body. A current round of multilateral trade negotiations was conducted in the Doha Development Agenda round.

The contract names which countries are involved in the agreement and what they intend to trade with the others. A few examples of ways that a multilateral agreement can make trade easier include reducing tarriffs and subsidies, eliminating embargoes, and more.

The purpose of the multilateral agreement is to make it easier for countries to participate in international trade with one another. This can greatly positively impact the economies of each involved party, which makes the agreement mutually beneficial.

In general, trade agreements between nations are either bilateral, involving only two nations, or multilateral. By their very nature, requiring concessions by several countries that have traditionally used trade barriers to protect certain industries or domestic goods, multilateral agreements are much more difficult to negotiate than bilateral agreements.

- Multilateral trade agreements strengthen the global economy by making developing countries competitive.
- They standardize import and export procedures, giving economic benefits to all member nations.
- Their complexity helps those that can take advantage of globalization, while those who cannot often face hardships.

12.2 MULTILATERAL AND BILATERAL TRADE NEGOTIATIONS

There are two main opinions within the public, the first being, that bilateral free trade is a first step towards a multilateral free trade, while others think that bilateral trade agreements are discriminatory and lead to a fragmentation of the world trade system as well as to a decline of the multilateral free trade system.

The main difference between multilateral and bilateral free trade agreements (FTA) is the number of participants. Multilateral trade agreements involve three or more countries without discrimination between those involved, whereas bilateral trade agreements consist between two countries. Both countries have certain privileges for example; they have favourable import quotas which are not available for other trading partners and only for the two nations which have the bilateral contract. Examples for bilateral free trade agreements are the Australian - New Zealand FTA and the Canada – United States FTA (Dictionary of Political Economy, 2006; Onpulson, 2006).

Multilateral negotiations are the most effective way of liberalizing trade in an interdependent global economy, because concessions in one bilateral or regional deal may undermine concessions made to another trading partner in an earlier deal. It is also important to mention that under multilateral trade agreements, regional trade arrangements take place and examples of this are the North American Free trade Agreement (NAFTA) and the European Union (EU). The most important organisation concerning multilateral negotiations, agreements and contracts is the WTO. This organization owns a unified package of agreements to which all members are committed and enforces global rules for international trade. The most important requirements are to reduce barriers to trade between nations and to secure that member nations are acting within the predetermined rules. The General Agreement on Tariffs and Trade (GATT) is the basic multilateral contract between WTO members (Farm Foundation, 2002, ITCD online 2004, Carbaugh, 2004).

12.3 TYPES OF TRADE AGREEMENTS

Trade agreements is an accord between two or more countries for a specific terms of trade, commerce, transit or investment. They mostly involve mutually beneficial concessions. Depending on the terms and concession agreed on by the participating bodies, there are several types of trade agreements-

12.3.1 Free Trade Agreement

A free trade agreement is an agreement in which two or more countries agree to provide preferential trade terms, tariff concession etc. to the partner country. Here a negative list of products and services is maintained by the negotiating countries on which the terms of FTA are not applicable hence it is more comprehensive than preferential trade agreement. India has negotiated FTA with many countries e.g. Sri Lanka and various trading blocs as well e.g. ASEAN.

12.3.2 Preferential Trade Agreement

In this type of agreement, two or more partners give preferential right of entry to certain products. This is done by reducing duties on an agreed number of tariff lines. Here a positive list is maintained i.e. the list of the products on which the two partners have agreed to provide preferential access. Tariff may even be reduced to zero for some products even in a PTA. India signed a PTA with Afghanistan.

12.3.3 Comprehensive Economic Partnership Agreement

Partnership agreement or cooperation agreement are more comprehensive than an FTA. CECA/CEPA also looks into the regulatory aspect of trade and encompasses and agreement covering the regulatory issues. CECA has the widest coverage. CEPA covers negotiation on the trade in services and investment, and other areas of economic partnership. It may even consider negotiation on areas such as trade facilitation and customs cooperation, competition, and IPR.

India has signed CEPAs with South Korea and Japan.

12.3.4 Comprehensive Economic Cooperation Agreement

CECA generally covers negotiation on trade tariff and TQR rates only. It is not as comprehensive as CEPA. India has signed CECA with Malaysia.

12.3.5 Framework agreement

Framework agreement primarily defines the scope and provisions of orientation of the potential agreement between the trading partners. It provides for some new area of discussions and set the period for future liberalisation. India has previously signed framework agreements with the ASEAN, Japan etc.

12.3.6 Early Harvest Scheme

An Early Harvest Scheme (EHS) is a precursor to an FTA/CECA/CEPA between two trading partners. For example early harvest scheme of RCEP has been rolled out. At this stage, the negotiating countries identify certain products for tariff liberalization pending the conclusion of actual FTA negotiations. An Early Harvest Scheme is thus a step towards enhanced engagement and confidence building.

12.4 EXAMPLES OF MULTILATERAL TRADE AGREEMENTS

Multilateral agreements are usually negotiated between countries that share a geographic region, and some of the most well known regional agreements are the Central American-Dominican Republic Free Trade Agreement (CAFTA). However, multilateral agreements can also be international in nature, with perhaps the most successful international trade agreement being the General Agreement on Trade and Tariffs (GATT), negotiated between 153 countries following the end of World War II.

Some regional trade agreements are multilateral. The largest had been the North American Free Trade Agreement (NAFTA), which was ratified on January 1, 1994. NAFTA quadrupled trade between the United States, Canada, and Mexico from its 1993 level to 2018.[12] On July 1, 2020, the U.S.-Mexico-Canada Agreement (USMCA) went into effect. The USMCA was a new trade agreement between the three countries that was negotiated under President Donald Trump.

The Central American-Dominican Republic Free Trade Agreement (CAFTA-DR) was signed on August 5, 2004. CAFTA-DR eliminated tariffs on more than 80% of U.S. exports to six countries: Costa Rica, the Dominican Republic, Guatemala, Honduras, Nicaragua, and El Salvador.[3]

The Trans-Pacific Partnership (TPP) would have been bigger than NAFTA. Negotiations concluded on October 4, 2015. After becoming president, Donald Trump withdrew from the agreement. He promised to replace it with bilateral agreements. The TPP was between the United States and 11 other countries bordering the Pacific Ocean. It would have removed tariffs and standardized business practices.

There is a debate as to their effectiveness. For instance, those in favour of multilateral agreements point to the economic benefits they provide smaller countries with emerging markets, while those against them claim that they provide multi-national companies increased control over the individual sovereignty of nations.

12.4.1 Advantages of Multilateral Trade Agreements

Liberal economists are perhaps the leading proponents of using multilateral agreements as the ideal way to encourage free and unencumbered global trade. The benefits they point to include:

- **Granting of "favored nation status**" – No nation that is a party to a multilateral agreement can be granted more favorable trading rights than any other party to the agreement. Each country is treated as an equal partner.
- **Best use of a nation's resources** – Countries can focus on producing only those goods that are deemed valuable by its partners to the agreement, creating efficiencies in the allocation of resources.
- **Exported goods are cheaper** – Reduced tariffs mean that countries exporting their products no longer face artificial barriers to trade.
- **Standardization of regulations** - Companies can more easily navigate trade between signatory countries as a result of agreed upon rules of commerce. In addition, international intellectual property rights can receive greater protection.

- **One agreement versus many** – While multilateral agreements are often complex by their very nature, they actually save countries the time and effort it takes to negotiate separate agreements with every potential trading partner.
- **Emerging markets flourish** – Bilateral agreements tend to favor the powerful. Multilateral agreements level the playing field for all participants, particularly the little guys who have been pushed around for years.

12.4.2 Disadvantages of Multilateral Agreements

Multilateral agreements also have their opponents. Their reasons for seeing these agreements as failing to provide any lasting benefits include:

- **Ceding of sovereign rights** – Countries that are partners in a multilateral agreement give up degrees of sovereignty over the way they conduct business with other countries, which often is in direct opposition to the democratic principles on which they were founded.
- **Some parties win, but some parties lose** – Certain industries within partner countries may be adversely affected by the low cost of imported goods by competing nations.
- **Complex and time-consuming negotiations** – Due to the complex nature of an agreement that must be negotiated by several countries with often competing interests, multilateral agreements can take a great deal of time to complete. There is no guarantee that after years of negotiation an agreement will actually be reached.
- **Misunderstandings and Misconceptions** - Negotiations during an agreement are often conducted in a confidential manner that breeds mistrust and controversy between corporations, special interest groups, labor organizations, and the media.
- **Rise of multi-national corporations** – Smaller businesses often find it difficult to compete with large corporations as traditional borders to trade are erased. This can lead to unemployment in certain industries and lower standards of living as wages are cut in order for these companies to compete.

12.5 ROLE OF MULTILATERAL TRADE AGREEMENTS IN INTERNATIONAL TRADE

Multilateral trade agreements strengthen the global economy by making developing countries competitive. They standardize import and export procedures, giving economic benefits to all member nations. Their complexity helps those that can take advantage of globalization, while those who cannot often face hardships.

12.6 INDIA IN MULTILATERAL TRADE AGREEMENTS

India has entered into bilateral and regional trading agreements over the years. These agreements, besides offering preferential tariff rates on the trade of goods among member countries, also provide for wider economic cooperation in the fields of trade in services, investment, and intellectual property. The preferential arrangement/plans under which India is receiving tariff preferences are the Generalized System of Preferences (GSP) and the Global System of Trade Preferences (GSTP). According to the Indian Government's Export Inspection Council (EIC). Presently, there are 43 countries participating under the GSTP and the EIC is the authorized agency to issue the certificate of origin under the GSTP.

India reports that it has 18 bilateral or regional trade agreements in force and the information on India's bilateral trade agreements is now available at the Ministry of Commerce and Industry.

Some Trade Agreements of India:

India has been consistently engaging at the regional and unilateral level across all the regions to increase economic cohesion. These agreements are complimentary to WTO based negotiations. These agreements aim at trade creation and trade diversification besides strengthening the political ties.

India opted out of the **Regional Comprehensive Economic Partnership (RCEP)** in November 2019, the 15-member FTA grouping that includes Japan, China and Australia, FTAs went into cold storage for India.

But in May 2021 came the announcement that **India-European Union** talks, which had stalled in 2013, would be resumed.

Both sides are **now engaged in internal preparations** to take these various strands of work forward.

Bilateral free trade agreements of India are being negotiated with the **United Arab Emirates, the United Kingdom, Australia and Canada.**

The agreement with the **UAE was 'close to finalisation'** while the FTA with Australia was at a 'very advanced stage.

Free Trade Agreements (FTAs) are signed mutually between nations to promote ease of trade and investment by removing restrictions such as tariffs, import quotas, and export limits. India has been proactive in engaging with other countries to enhance international trade relations and has signed thirteen FTAs with nations across the globe. One of the prominent real-world examples of free trade agreements is the European Union wherein the member nations form an essentially borderless single entity for trade, and the adoption of the Euro by most of those nations smooth's the way forward.

The United States currently has several free trade agreements. It includes multi-nation agreements such as the North American Free Trade Agreement (NAFTA), which covers the US, Canada, and Mexico, and the Central American Free Trade Agreement (CAFTA) which includes most of the nations of Central America.

These agreements show that about half of all goods entering the US come free of tariffs, according to government figures. Free Trade provides a great advantage as it allows permits for inexpensive imports and exports without tariffs or other trade barriers. A group of countries agrees to lower their tariffs or other barriers to facilitate more exchanges with their trading partners. As a result, all countries benefit from lower prices and access to one another's resources.

The Association of Southeast Asian Nations (ASEAN) region is one of the regions which is on the priority list for India. There are various similarities between India and the ASEAN nations in terms of their culture and religion. The similarity also exists because of the proximity with India, especially with the Northeast part of India. The India Act policy has contributed to significant growth during the last decade in trade and investment opportunities.

During the period of 2021-22, the merchandise trade between India and ASEAN countries rose to US$ 110.40 billion.

Significance, Models, and Advantages of FTAs

The free trade agreement is often signed through the mutual and formal agreement of the nations involved. It could simply mean the absence of trade restrictions among the nations involved in the policy. For example, a nation might allow free trade with another nation, however, does it with exceptions that forbid the import of specific drugs not approved by its regulators, animals that have not been vaccinated, or processed foods that do not meet its standards. It might also implement some policies which will exempt specific products from tariff-free status to protect home producers from foreign competition in their industries.

International trade is, in theory, no different than trade between neighbours, cities, or nations. However, it enables companies in each nation to concentrate on creating and marketing commodities that make the best use of local resources while importing goods that are scarce or unavailable domestically. This combination of domestic production and international trade enables economies to grow more quickly while better satisfying consumer demands.

There are various models of free trade which involve mercantilism and comparative advantage. The theory of mercantilism was dominating global trade before the 1800s. Under this trade idea, the priority was on having a favourable balance of trade relative to other countries and accumulating more gold and silver. To attain a favourable trade balance, countries would often use trade barriers like taxes and tariffs to discourage their residents from purchasing foreign goods. This idea incentivised the consumers to purchase the locally made product, thereby supporting domestic industries. However, the concept of comparative advantage states that countries can attain the maximum benefits through free trade. Ricardo, who introduced this concept demonstrated that as soon as countries prioritize the production of goods, they can produce more at a comparatively cheaper cost than other countries (which is where they have a comparative advantage) they will be able to produce more goods in total than they would by limiting trade.

FTAs support the growth of a nation in several ways by contributing to its rapid development. As it allows more focus on exports and resources where they have a strong comparative advantage. he significant focus help countries to attract foreign investment capital and provide relatively high-paying jobs for local workers as well. Free trade also creates a competitive environment where countries strive to provide the lowest possible prices for their resources which is in a way beneficial for consumers. Along with all the benefits, it has some challenges such as unemployment and business losses, more reliance of countries on the global market, etc.

Key Agreements Boosting India-ASEAN Trade Relations

Various agreements have contributed to the growth of India-ASEAN trade relations.
India ASEAN Comprehensive Economic Cooperation Agreement (CECA) - Trade in Goods, Services, and Investment Agreement (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam).

Since trade and investment are top priorities for ASEAN and India's economic cooperation, the ASEAN-India Trade in Goods Agreement (AITIGA), which went into effect in January 2010, has remained at the forefront of interaction. According to the Agreement, India and ASEAN Member States have both agreed to liberalise tariffs on more than 90% of commodities and gradually reduce and eliminate levies on the remaining 76.4% of goods. Since the implementation of AITIGA, traffic in goods between ASEAN and India has grown dramatically, with an increase in exports of 23% and an increase in imports of 55% over the past ten years. There has been an increase in imports, particularly from Cambodia, Singapore, and Vietnam.

India-Singapore Comprehensive Economic Cooperation Agreement (CECA)

The bilateral commerce between Singapore and India has increased significantly. The two nations also agreed to liberalise the export rule of origin, rationalise product-specific rules, and include provisions on the Certificate of Origin to promote balanced trade. Tariff concessions will now apply to 30 more products.

India-Malaysia Comprehensive Economic Cooperation Agreement (MICECA)

In 2011, the MICECA was signed between India and Malaysia, the agreement includes concessions and reductions in tariffs for trading certain goods, services, investments, and movement of natural persons. Although the pandemic hit most parts of the world, Malaysia and India maintained their strong trade relations. As a result, the total trade expanded by 26% in 2021. The import in India from Malaysia increased by US$ 5.9 billion and the exports increased by US$ 3.12 billion.

India Thailand FTA - Early Harvest Scheme (EHS)

In 2006, India and Thailand have implemented the Early Harvest Scheme (EHS) to identify specific products for tariff reduction during the ongoing negotiations on the Free Trade Agreement. This is the first step toward the initial phase of the proposed comprehensive FTA. This program supports the tariff reductions to be nil for 82 products including fruits, processed food, gems and jewellery, iron and steel, auto parts, and electronic goods.

The India-UK FTA

The FTA between India and UK is still being discussed among the ministries of the nation. The considerable positive sentiments over the potential of this trade agreement are anticipated to be of great economic benefit to both nations. This free trade pact will provide a major thrust to Indian export and labour-intensive sectors like leather, textile, jewellery, IT, ITES, nursing, education, and healthcare. The PMs of both countries are working intensively on an ambitious roadmap for 2030. The data of India’s bilateral merchandise trade with the UK was worth US$ 17.4 billion in 2021-22, higher than the previous record of US$ 16.8 billion in 2018-19.

In addition to the above-mentioned trade agreements, India has collectively signed a total of 13 free trade agreements with its trading partners out of which 5 are described in brief. Other FTAs are-

- India-Sri-Lanka free trade agreement
- the agreement on the South Asian Free Trade Area (SAFTA) (India, Pakistan, Nepal, Sri Lanka, Bangladesh, Bhutan, the Maldives, and Afghanistan),
- India-Nepal treaty of trade
- India-Bhutan agreement on trade, commerce, and transit
- India-South Korea Comprehensive Economic Partnership Agreement (CEPA)
- India-Japan CEPA
- India-Malaysia CECA
- India-Mauritius Comprehensive Economic Cooperation and Partnership Agreement (CECPA)
- Apart from the free trade agreements, India has also signed 6 limited coverage preferential trade agreements (PTAs)-
- Asia Pacific Trade Agreement (APTA)
- Global System of Trade Preferences (GSTP)
- India-Afghanistan PTA
- SAARC Preferential Trading Agreement (SAPTA)
- India-MERCOSUR PTA
- India-Chile PTA

Way forward

Free Trade in a broader term refers to the policies that allow the permit of inexpensive imports and exports, without tariffs or other trade barriers. India has been working closely across the globe to establish more of FTAs. The negotiation under FTA should include terms and conditions to introduce more transparency and predictability in terms of non-tariff barriers to ensure a less cumbersome compliance procedure. There should be a discussion on resolving geopolitical issues and there should be reform in the selection of trade partners to expand free trade policy. India is also exploring more regions that are ready for a trade agreement with India and there is a huge potential to widen the access of the market to regions like Africa, and Central and Southeast Asia. There are some mismatches in the opinion of people across the nation on the implementation of free trade policies. The main issue which is being contradicted by the public includes unfair competition from countries where lower labour costs allow price-cutting and a loss of good-paying jobs to manufacturers abroad. Although the issue is being addressed by reforms and reviewing of the policies and relations with other countries.

Bilateral trade

On behalf of the EU, the Commission negotiates and implements bilateral trade agreements with non-EU countries. Directorate General for Internal Market, Industry, Entrepreneurship and SMEs is responsible for the negotiation and implementation of preferential trade regimes for processed agricultural products (PAPs).

The EU has concluded, or is negotiating, these kinds of bilateral trade agreements with:

- OECD countries (USA, Canada, Japan, Switzerland, the European Economic Area, Mexico, Chile and South Korea);

- Euro-Mediterranean countries (Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, the Palestinian Authority, Syria, Tunisia and Turkey);
- Mercosur countries (Argentina, Brazil, Paraguay, Uruguay and Venezuela);
- Andean countries (Columbia, Peru, Equator and Bolivia);
- Central American countries (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama);
- Gulf Co-operation Council countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates);
- Balkan countries;
- ACP (Africa, Caribbean and Pacific) countries.

The agreement with the **UAE was 'close to finalisation'** while the FTA with Australia was at a 'very advanced stage.

Important Trade Agreements of India:

There are different types of trade agreements that enable preferential market access between India and signatory countries or trade blocs -preferential trade agreements (PTA), free trade agreements (FTA), and Comprehensive Economic Cooperation Agreements (CECA) and Comprehensive Economic Partnership Agreements (CEPA).

A preferential trade agreement (PTA) involves two or more partners agreeing to reduce tariffs on an agreed number of tariff lines (products). The list of products on which the partners agree to reduce duty is called the positive list. In general, PTAs do not cover substantially all trade. The India Mercosur Preferential Trade Agreement is an example of a PTA.

A free trade agreement (FTA) also involves reducing or eliminating tariffs on items traded between the partner countries; however each maintains individual tariff structure for non-members. The key difference between an FTA and a PTA is that PTAs have a positive list of products on which duty is to be reduced, while an FTA uses a negative list on which duty is not reduced or eliminated. Thus, compared to a PTA, FTAs are generally more ambitious in coverage of tariff lines on which duty is to be reduced. The India Sri Lanka Free Trade Agreement is an example of an FTA.

Comprehensive Economic Cooperation Agreement (CECA) and Comprehensive Economic Partnership Agreement (CEPA) are agreements which consist of an integrated package on goods, services and investment, as well as trade facilitation and rule-making in areas such as intellectual property, government procurement, technical standards and sanitary and phytosanitary issues. The India Korea CEPA is one such example and it covers a broad range of other areas such trade facilitation, customs cooperation, investment, competition, intellectual property rights etc. CECA/CEPAs are more comprehensive and ambitious than FTAs in terms of coverage of areas and the type of commitments. While a traditional FTA focuses mainly on goods, a CECA/CEPA provides holistic coverage of many areas like services, investment, competition, government procurement, disputes etc. Further, a CECA/CEPA looks deeper into the regulatory aspects of trade than an FTA. Due to this, it encompasses mutual recognition agreements (MRAs) that cover the regulatory regimes of the partners. An MRA recognises different regulatory regimes of partners on the presumption that they achieve the same end objectives.

India has entered into bilateral and regional trading agreements over the years. These agreements, besides offering preferential tariff rates on the trade of goods among member countries, also provide for wider economic cooperation in the fields of trade in services, investment, and intellectual property.

The preferential arrangement/plans under which India is receiving tariff preferences are the Generalized System of Preferences (GSP) and the Global System of Trade Preferences (GSTP). According to the Indian Government's Export Inspection Council (EIC). Presently, there are 43 countries participating under the GSTP and the EIC is the authorized agency to issue the certificate of origin under the GSTP.

India reports that it has 18 bilateral or regional trade agreements in force and the information on India's bilateral trade agreements is now available at the Ministry of Commerce and Industry

Important Trade Agreements of India:

Comprehensive Economic Cooperation and Partnership Agreement (CECPA) between India and Mauritius on April 2021

South Asia Preferential Trading Agreement (SAPTA): It is for promoting trade amongst the member countries came into effect in 1995.

South Asian Free Trade Area (SAFTA): A Free Trade Agreement confined to goods, but excluding all services like information technology. Agreement was signed to reduce customs duties of all traded goods to zero by the year 2016.

Asia Pacific Trade Agreement (APTA):

Previously the Bangkok Agreement, it's a **preferential tariff arrangement** that aimed at promoting intra-regional trade through the exchange of mutually agreed concessions by member countries.

- India Singapore CECA. 29 June 2005. ...
- India Chile PTA. Trade Agreement between India and Argentina. ...
- India Japan CEPA. India-Ecuador Joint Economic and Trade Committee (JETCO) ...
- India Afghanistan PTA. ...
- India MERCOSUR PTA. ...
- India Sri Lanka FTA. ...
- Framework Agreement with Thailand.
- Comprehensive Economic Partnership Agreement (CEPA)
- Economic Cooperation and Trade Agreement (ECTA).

12.7 SUMMARY

A Free trade Agreement (FTA) is an agreement between two or more countries where the countries agree on certain obligations that affect trade in goods and services, and protections for investors and intellectual property rights, among other topics. The World Trade Organization (WTO) Agreements create an international trade legal framework for 164

economies around the world. These Agreements cover goods, services, intellectual property, standards, investment and other issues that impact the flow of trade.

12.8 KEY WORDS

Free trade agreements
Multilateral trade agreements
Bilateral trade agreements
Trade Negotiations
International trade.

12.10 FURTHER READINGS

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Model Question Paper **305C021**

M.Com Degree Examinations

Second Year - III Semester

Paper-V International Business

Time: Three hours **Maximum: 70 Marks**

SECTION- A (4x5=20 Marks)

Answer any FOUR of the following

1. a. Mergers and Acquisitions
   b. Drivers of International Business
   c. International Production
   d. Free Trade agreements
   e. Characteristics of MNCs
   f. Evolution of International Business
   g. Foreign Direct Investments
   h. Framework International Business

SECTION-B (5x10=50 Marks)

Answer all the following questions

2. a. Explain the theories of Mercantilism and Absolute advantage of International Business

   Or

   b. Define International Business. Explain various modes and approaches of International Business.

3. a. Define MNCs. Explain appropriate structure and strategic planning of MNCs.

   Or

   b. Define Regional Trade Grouping. Explain the role and functions of EU and SAARC

4. a. Explain the advantages and disadvantages of International Business.

   Or

   b. Describe the factors effecting International production.

5. a. Explain the role human resources in International Business

   Or

   b. Explain the characteristics and challenges faced in International Business.

6. a. Explain role and Functions of WTO in International Business

   Or

   b. Explain advantages and disadvantages of Free trade agreements.