International Business Dynamics

Venkatesh Ganapathy



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VENKATESH GANAPATHY

INTERNATIONAL BUSINESS DYNAMICS

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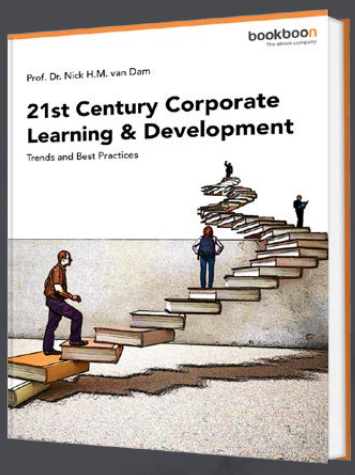
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1 INTRODUCTION TO INTERNATIONAL BUSINESS

LEARNING OUTCOMES

- To get a glimpse of international business operations
- To understand the features of international business

INTRODUCTION

International business involves those business transactions that involve the crossing of national boundaries. International business is characterized by product presence in different markets, production base across the globe and investment in international services like banking, advertising, tourism, retailing and construction. There are human resource challenges associated with international business operations resulting due high diversity of work force and cross-cultural influences.

International Trade is the branch of economics concerned with the exchange of goods and services with foreign countries. As economies across the globe strive to attract foreign direct investment to boost their economy, international business operations have assumed greater significance.

There has been a drastic transformation in the global business ecosystem now. Earlier, innovations were confined to Western nations. Now, companies in the West are looking at emerging economies for innovations due to the cost advantages. Emerging economies like India offer benefits like a skilled and competent workforce who can be hired at a much lesser cost than similar workforce in the West. Developed economies are now aspiring to penetrate the markets of emerging economies like Brazil, China, India and South Africa. As multi-national corporations expand their footprint across the globe, environmental issues and challenges of making peace with communities in developing nations is also shooting in prominence.

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As world markets integrate and geographical barriers diminish, businesses across the globe are compelled to explore markets outside the home country to scale up the business. Investment policies of nations have become more supportive and trade barriers have diminished.



As of 2019, even though the fear of a trade war between USA and China looms large businesses are optimistic and still upbeat about the opportunities presented by international business operations. The recently concluded G20 summit in Osaka, Japan showed that world leaders differ in their approach towards climate change. The summit highlighted concerns about plastic waste and the need for ecological and social sustainability. The summit has stressed the need to promote international trade. US chose to withdraw from the 2015 Paris agreement. The G20 leaders agreed for rules-based multilateral trade liberation by providing a push to World Trade Organisation's e-commerce negotiations. Thus, it won't be

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wrong to say that political climate in various nations have a deep impact on international business operations.

Growth of Multinational corporations and transnational corporations reflect the need and importance of international business operations. If we look at the brighter side of this development, it presents a win-win situation for both businesses as well as the host countries. Multinational corporations get an opportunity to scale up their businesses and take advantage of unpenetrated markets. Host countries benefit as customers get a wide choice of products and services and as the country stars attracting foreign investments, there is a growth in industrial output and employment levels. This boosts the growth of GDP paving the path for overall economic development. Multinational corporations can have access to resources at a cheaper rate in foreign markets.

Let us now look at some of the key terminologies in international trade:

BALANCE OF PAYMENT

- A statement that summarizes for a specified period of time, monetary transactions of an economy with the rest of the world.
- Systematic record of all the transactions between residents of a country and the rest of the world.
- Difference between merchandise exports and merchandise imports of a country.

BALANCE OF TRADE

- Transactions of movable goods with changes of ownership between resident and non residents

ETHNOCENTRIC APPROACH

All key management positions are filled by parent country nationals (P&G, Philips)

POLYCENTRIC APPROACH

Host country nationals are recruited to manage subsidiaries; parent country nationals occupy key positions at corporate headquarters. The firm is less likely to suffer from cultural myopia.

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GEOCENTRIC APPROACH

This approach seeks the best people for key jobs throughout the organisation, regardless of nationality. Firm makes the best use of human resources. A geocentric policy enables a firm to build a cadre of international executives who feel at home working in a number of cultures.



Fig : Apple has sharpened its focus on the Indian market
Source: https://dazeinfo.com/2017/05/11/apple-iphone-sales-india-worldwide/

FEATURES OF INTERNATIONAL BUSINESS

The common features of International Business are delineated below:

1. Large scale operations
2. Integration of economies of several nations across the globe
3. Domination of multinational corporations
4. Relationship between host country and home country
5. Importance of science, research and technology
6. Growth in communications, transportation and information technologies
7. Role played by multilateral organisations impacts international trade
8. Political factors across the globe impact international business operations

TO SUM UP

International business comprises all the commercial activities intended to promote the transfer of goods, services, resources, people, ideas and technologies across national boundaries.

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The study of international business involves understanding the effects of these activities on domestic and foreign markets, countries, governments, companies and individuals. International businesses need to recognize the diversity of the global marketplace. They must be adept in handling the risks of doing business in a global market that is characterized by uncertainties and risks.

Companies taking part in international business operations can take advantage of specialized expertise and abundant factors of production to deliver goods and services in the international marketplace. Competition in domestic markets increases. This forces companies to become more innovative and ensure that their resources are used as efficiently as possible.

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2 DRIVERS OF INTERNATIONAL BUSINESS

LEARNING OUTCOMES

- To identify the differences between domestic business and international business
- To examine the drivers of international business
- To review the objectives of a company in pursuit of international business
- To understand the role of trading blocs in the development of international business

INTRODUCTION

International business is a product of mainly three elements

1. External environment: International business environment policies and attitudes of host nations
2. Domestic environment: Home business environment and policies and attitudes of the local government
3. Self-motivation: Vision, values, attitudes, intentions, policies/ strategies and efforts by the business organizations themselves.

A lot will depend on availability of resources, competition, foreign governments and their policies, international politics, policies of local governments, geography, demography, attitudes, habits, economy and social psychology of people in foreign countries.



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The rate at which globalization impacts businesses in different countries/ regions will vary. It will depend on their willingness, preparedness and efforts. The advances in technology, communication and information exchange between people all over the world has become easier, quicker and cheaper. Movement of people, goods and services has become faster due to improvements in technology. Therefore, international business is increasing rapidly. Most MNCs are based in the developed parts of the world like USA, European Union and Japan. Among the MNCs from developing countries, most are from South East Asia.

DRIVERS OF INTERNATIONAL BUSINESS

- Developed countries operating below their capacity seek developing markets to tap the opportunities
- Growth of BRIC countries like Brazil, Russia, India and China
- MNCs seek business in low wage countries to take advantage of low cost production; however they also need to understand that the risks of low productivity have to be managed. MNCs try to strike a trade-off.
- Changing demographics – In the days to come, India will have a surplus working population. Indians are willing to take up job overseas.
- Regional trading blocs are adding to the pace of globalization.
- Developing markets have huge markets to increase sales and profits.
- MNCs locate subsidiaries in low wage countries to take advantage of low cost production.
- Demographics are changing. Composition of population has also undergone a drastic transformation. India has a large low cost and skilled workforce.
- Growth of regional trading blocs. WTO, EU, NAFTA, MERCOSUR, FTAA are examples of trading blocs that promote international business by removing trade and investment barriers.
- Declining trade and investment barriers
- Growth in technology
- Growth of rapidly developing economies like China, India, Mexico, Brazil, South East Asia.
- There is money and opportunity to grow business in international markets much more quickly
- Firms seek resources in foreign countries. Natural resources like raw materials and minerals and cheap labor are available in Mexico, Malaysia and Taiwan. These nations have attracted FDI. There is a need for acquiring technology. This prompted joint ventures between Hero and Honda, TVS and Suzuki in India.

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Taiwanese, Korean and Indian companies collaborate with US companies for technology.

- Globalization is triggered by world bodies like WTO that help free trade, help negotiate further opening of markets and settle trade disputes between members.

World Trade Organization, European Union, North American Free Trade Association (NAFTA), MERCOSUR (South American trading bloc) – these are major alliances among countries.

ROLE OF TRADING BLOCS

Trading blocs promote international business by removing trade and investment barriers. Integration among countries leads to efficient allocation of resources throughout the trading area, developing new technologies and products and elimination of old technologies. This has resulted in large scale restructuring of industries and firms in the European Union, with relocation of industry and many cross-border mergers and alliances.



Source: https://mrshearingbusinessstudies.weebly.com/415-trading-blocs.html

But trading blocs might compete with each other. Free trade will exist within each bloc and each bloc will protect its market from outside competition with high tariffs. EU & NAFTA became economic fortresses that shut out foreign producers with high tariff barriers.

Trade blocs create more job opportunities. Jobs were created in the US because of greater exports to Mexico (after NAFTA was created). There was easy movement of people among alliance partners in the trade blocs and replication of best HR practices. But jobs can also get shifted due to low wage and low cost countries.

Declining trade and investment barriers in domestic countries have contributed to globalization.

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INFANT INDUSTRY ARGUMENT

Protect domestic industries. Increase tariffs for imported commodities. This was the argument against globalization and foreign trade. India too had a highly protectionist regime before the wave of globalization swept the Indian business landscape. The problem with protectionism is that it makes domestic industries complacent. It is time for domestic industry to learn business, produce more to benefit from economies of scale and lower unit cost of products and reduce prices. Trade unionism in India led to decreased competitiveness of Indian industries apart from lower productivity.

Infant will eventually grow and become competitive with developed country producers. Domestic producers can produce for domestic and global market. It can work both ways. If there is too much competition in the domestic market, the local manufacturers can look at exports. If they have excess capacity and are producing a surplus, they can use the surplus to meet the demand in foreign shores.

TECHNOLOGICAL CHANGES

Rapid strides in communication, transportation and information processing have redefined the way a business operates. Today customers are becoming more fastidious than ever. MNCs are able to locate production facilities anywhere in the world to take advantage of low cost production. This has helped create job opportunities in Philippines, Mexico, China and India.

DIFFERENCES BETWEEN INTERNATIONAL BUSINESS AND DOMESTIC BUSINESS

The differences are pronounced in the areas of currency, interest rates, inflation, taxation systems, government regulations, language, cultural and economic barriers. Buyers of foreign goods pay in a different currency. Exchange rate fluctuations are at risk. Despite WTO, quotas and licenses make movement of goods difficult across borders.

Differences in customs, language, cultural and economic barriers make selling procedures in foreign markets more difficult. Advertising strategies have to be different as local laws are different.

In domestic markets, a businessman faces a single pattern of short-term and long term interest rates, single tax system and only one rate of inflation. Businesses with operations in number of countries will have different variables.

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In international business, managerial practices need to be fine tuned to correspond with the different environmental variables. A firm in international business needs to adopt a geocentric approach wherein executives believe that a global view is needed in both the headquarters of parent company and various subsidiaries and that the best individuals (regardless of home or host country) origin should be utilized to solve company problems anywhere in the world. A geocentric approach is often considered difficult because managers have to acquire both local and global knowledge.



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MAJOR OBJECTIVES FOR COMPANIES TO ENGAGE IN INTERNATIONAL BUSINESS

a. Expanding Sales
b. Acquiring Resources
c. Minimizing Risk

Volkswagen (Germany), Ericsson (Sweden), IBM (United States), Michelin Tires (France), Nestle (Switzerland) and Sony (Japan) derive more than half their sales outside their home countries. Operating in countries with different business cycles can minimize swings in sales and profits. Sales decrease in a country that is facing recession and increase in a country that is expanding economically.

Companies can work together on an international basis by way of joint ventures, licensing agreements, management contracts, minority ownership and long term contractual arrangements.

Strategic alliance is an agreement that is of critical importance to one or more partners or to an agreement that does not involve joint ownership.

A multinational enterprise takes a worldwide view of markets and production – it is willing to consider market and production locations anywhere in the world. Off-shoring is the transferring of production abroad – is controversial in terms of who benefits when costs are reduced and whether the process exchanges good jobs for bad ones.



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A company can engage in international business through various operating modes, including exporting and importing merchandise and services, direct and portfolio investments, and collaborative arrangements with other companies.

The U N Human Development Index (HDI)

Specifically, the HDI measures the average achievements in a country on three dimensions

a. Longevity, as measured by life expectancy at birth
b. Knowledge, as measured by adult literacy rate
c. Standard of living, as measured by Gross National Income per capita

The HDI aims to capture long term progress in human development rather than short term changes.

BALANCE OF PAYMENTS

A country's balance of payments known as statement of international transactions, is the statement of the balance of a country's trade and financial transactions as conducted by individuals, businesses and government agencies located in that nation with the rest of the world over a specific period (usually one year).

The BoP has two accounts – current account and capital account. Current account tracks all trade activity in merchandise. Capital account tracks both loans given to foreigners and loans received by citizens.

CURRENT ACCOUNT

This comprises trade in goods and services and income from assets abroad.

- Value of exports and imports of physical goods, such as oil, grain or computers.
- Receipts and payments for services like banking and advertising or other intangible goods such as copyright and cross border dividend and interest payments.
- Private transfers, such as money sent home by expatriate workers.
- Official transfers such as international aid, on which the government expects no returns.

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CAPITAL ACCOUNT

This comprises transactions in real or in financial assets between countries – example – sale of real estate to a foreign investor.

- Long term capital flows (i.e. money invested in foreign firms as well as profits made by selling those investments and returning the money home).
- Short term capital flows (i.e. money invested in foreign currencies by international speculators as well as funds moved around the world for business purposes by companies with international operations).
- Merchandise trade balance = Net balance of exports minus imports of merchandise

PURE MARKET ECONOMY

- Goods and services that a country produces and the quantity in which they are produced, are not planned by anyone.
- Rather, price and quantity are determined by the invisible hand of supply and demand.

In a pure command economy, the government plans what goods and services a country produces, the quantity in which they are produced, and the price at which they are sold.

A mixed economy includes some elements of a market and command economy. Market forces as well as the government play a significant role in directing the investment activities of private enterprise and consumption activities of individuals. The transition to a market economy happens when command and mixed economies liberalize their economic policies and transfer more ownership and control of the economy to market forces.

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3 IMPORTANCE OF INTERNATIONAL BUSINESS FOR ECONOMY

LEARNING OUTCOMES

- To understand the relevance of international business for an economy
- To examine the reasons for importance of international business

INTERNATIONAL BUSINESS – A CRUCIAL VENTURE

International business is any firm that engages in International trade or investment. A firm does not have to become a multinational enterprise, investing directly in operations in other countries, to engage in international business, although multinational enterprises are international business. All a firm has to do is export or import products to/from other countries. International Business includes business transactions that involve the crossing of national boundaries. International Business is a four dimensional construct exhibiting the following major characteristics.

- Internationalism of market presence.
- Globalization of supply chain.
- Globalization of capitalization base
- Globalization of corporate mind-set.

Two macro factors seem to underline the trend towards international business. The first is the decline in barriers to the free flow of goods, services and capital. The second factor is technological change, particularly the dramatic developments in recent years in communication, information processing and transportations technologies.

Differences between countries require that an international business vary its practices depending on the operating country. Hence appropriate policies and strategies should be adopted for coping with them. An international business must decide where in world to site its production activities to minimize cost and to maximize the value added. Then it must decide how best to coordinate and control its globally dispersed production activities.

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An international business must also decide which foreign markets to enter and which to avoid. Apart from the basic cultural and market differences from nation to nation, a company also has to pay special attention to locational advantages that stem from nation to nation variations in manufacturing and distribution costs, the problems of fluctuations, exchange rates and the economic and political demands of host governments.

One of the biggest concerns of competing in foreign markets is whether to customize the company's offerings to cater to the tastes and preferences of local buyers in each different country market or whether to offer a mostly standardized product worldwide. While being responsive to the local tastes, makes a company's products more appealing to local buyers, customizing a company's products more appealing to local buyers, customizing a company's products country by country may have the effect of raising production and distribution costs due to the greatest variety of design and components.

However, large segments of population in many countries believe that international business has detrimental effects on living standards and the environment.



Falling barriers to international trade destroy manufacturing jobs in wealthy advanced economies such us U.S and UK. Failing trade barriers allows firms to move their manufacturing activities to the countries where wage rates are much lower. A second source of concern is that free trading encourages firms from advanced facilities to less developed countries that lack adequate regulations to protect labour and the environment from abused by the unscrupulous.

Critics of globalization argue that despite the supposed benefits associated with trade and investment over the last hundred years or so the gap between the rich and poor nations of the world has gotten wider. Although the reasons for economic stagnation vary, several factors stand out, none of which have anything to do with free trade or globalization.

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The importance of international business can be delineated as below:

1. Earn foreign exchange for the country
2. Ensure optimum utilization of resources
3. Earn profits
4. Scale up the business
5. Spread business risks
6. Improve organizational benefits
7. Expand and diversify
8. Increase competition in the market

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4 PERFORMANCE INDICATORS OF INTERNATIONAL BUSINESS

LEARNING OUTCOME

- To identify the key performance indicators of international business operations

There are several performance indicators that can be used to measure the performance of international business operations. The challenge is to quantify the performance measures.

1. Financial : Return on Investment / Increase in top line & bottom line
2. Success of globalization and glocalisation efforts
3. Good relations with host countries
4. Good employee relations
5. Easy adaptation of local culture and blending into the culture
6. Good environmental performance
7. Contribution to GDP and growth of host country
8. Successful introduction of new technologies in subsidiaries
9. The level of interaction between headquarters and subsidiaries
10. The number of cross-country movements in the organization
11. CSR activities in host countries
12. Enduring strategic alliances / joint venture partnerships
13. Excellent customer feedback about products/ services
14. Number of innovations
15. Less number of legal cases
16. An organization structure responsive to local needs of a subsidiary
17. Healthy competition between subsidiaries of a MNE
18. Efforts taken by organization for training employees in subsidiaries
19. Level of tax payments in the host country
20. Standard code of conduct / Ethical practices
21. Success in international marketing efforts
22. Intelligent and optimal resource utilization in host country
23. Responsiveness of MNC to changing local conditions
24. Greater understanding of political conditions in the host country
25. Experience and expertise gained by the MNC over a period of time in a host country which stimulates confidence and trust of employees
26. Optimal management of fixed and current assets - a good financial management system.

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27. Successful integration of global HR practices in a host country – reflected by good image in the media, reduced attrition and recognition of MNC as a great place to work.
28. Adoption of global international SCM practices
29. Capacity utilization in the manufacturing plants in subsidiaries

INTERNATIONAL BUSINESS - A CRUCIAL VENTURE

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Decline in trade barriers and changes in technology have led to growth in international business. Dramatic improvements in communication, information processing and transportation technologies have altered the business landscape. International business must vary its practices based on the host country. This needs appropriate business procedures, policies and strategies.

A business that wishes to expand on an international scale must know where to source raw materials cheap, where to manufacture products with the highest production efficiency and how the various production activities can be dispersed. Foreign exchange rates, cultural factors, economic and political factors play a crucial role in the successful operation of an international business.

The major challenge faced by a MNC is how to customize the products as per the preferences of local customers. Shorter production runs, greater standardization and capturing scale economies will result in success of international business efforts. There is always a tension to customize and maintain cost competitiveness.

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International business operations have faced resistance from many countries due to loss of employment, losses suffered by domestic industries and environmental abuse by foreign firms. Falling trade barriers has resulted in MNCs adopting a transnational approach to source resources where they are available cheap.

Critics of globalization argue that despite the supposed benefits associated with trade and investment over the last hundred years or so the gap between the rich and poor nations of the world has gotten wider. This remains a debatable topic.

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5 FORMS OF INTERNATIONAL BUSINESS

LEARNING OUTCOME

- To understand the various forms of international business

International business refers to business activities that are conducted across national boundaries. A company can enter international markets by adopting the following route.

1. A country can import or export goods. It is the first choice when businesses desire to expand their business with a lower capital outlay.
2. Licensing is arrangement between two firms such that a firm (licensor) that allows another firm to use its intellectual property like brand name, copyright, patent, technology, trademark etc. for a specific period of time. The licensor earns royalty from this arrangement. A company may resort to licensing when domestic production costs are high or if the government regulations are too stringent or if the company desires to sell standardized products everywhere.



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3. Franchising – A parent company (franchiser) gives the right to another company (franchisee) to do business using the franchiser's name and products in a prescribed manner. Franchisees have to follow stricter guidelines and are more popular with restaurants, hotels, and rental services.



4. A strategic alliance is formed when two or more companies in different countries agree to work together for mutual gain. A joint venture is a strategic alliance in which partners across the globe collectively establish another company to produce goods and services. Companies share the production cost, technologies, development, and sales networks leading to a win-win situation.
5. Foreign direct investment is a company's physical investment in a foreign country. Companies indulge in FDI to get benefits from cheaper labor costs, tax exemptions, and other privileges in that foreign country. The host country will get benefits by the introduction of new products, services, technologies and managerial skills.



International business is "any commercial transaction taking place across the boundary lines of a sovereign entity, it may take place either between, countries or companies or both".

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FORMS OF IB

1. Exporting- Many manufacturing firms begin their global expansion as exporters and only later switch to another mode for serving a foreign market.

   Advantages

   - It avoids the often substantial costs of establishing manufacturing operations in the host country.
   - Exporting may help a firm achieve experience curve and location economies. By manufacturing the product in a centralized location and exporting it to other national markets, the firm may realize substantial scales of economies from its global sales volume.

   Disadvantages

   - Exporting from the firm's home base may not be appropriate if lower-cost locations for manufacturing the product can be found abroad (i.e., if the firm can realize location economies by moving production elsewhere).
   - High transport costs can make exporting uneconomical, particularly for bulk products.

2. Turnkey Projects- Firms that specialize in the design, construction, and start-up of turnkey plants are common in some industries. In a turnkey projects, the contractor agrees to handle every detail of the project for a foreign client, including the training of operating personnel. At completion of the foreign client is handed the "key" to a plant that is ready for full operation- hence the term turnkey. Turnkey projects are most common in the chemical, pharmaceutical, petroleum refining and metal refining industries, all of which use complex, expensive production technologies.

   Advantages

   - The know-how required to assemble and run a technologically complex process, such as refining petroleum or steel, is a valuable asset.

   Disadvantages

   - The firms that enter into a turnkey deal will have no long-term interests in the foreign country.
   - The firm that enters into a turnkey project with a foreign enterprise may inadvertently create a competitor.

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3. Licensing- This is an agreement whereby a licensor grants the rights to intangible property to another entity for a specified period and in return, the licensor receives a royalty fee from the licensee. Intangible property includes patents, invention, formulas, processes, design, copyrights and trademarks. **Example: -** To enter the Japanese market, Xerox established a joint venture with Fuji photo that is known as Fuji Xerox.

   Advantages

   - It puts up most of the capital necessary to get the overseas operation going, thus advantages is that the firm does not have to bear the development costs and risk associated with opening a foreign market.

   Disadvantages

   - It doesn't give a firm the tight control over manufacturing, marketing and strategy that is required for realizing experience curve and location economies.
   - Competing in global market may require a firm to coordinate strategic moves across countries by using profits earned in one country to support competitive attacks in another.

4. Franchising- This is a legal and commercial relationship between the owner of a trademark, service market, brand name, or advertising symbol (the franchisor) and an individual or organisation (the franchisee) wishing to use that identification in a business. The franchise governs the method of conducting business between the two parties. Generally, a franchisee sells goods or services supplied by the franchisor or that meet the franchisor's quality standards.

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Advantages

- Established brand and customer base. By far the biggest advantage of buying into an established franchise is the strength of the brand and loyalty of its customers.
- Marketing support- franchises often have the support of a national campaign, as well as prepared marketing materials for a local campaign.

Disadvantages

- Initial payout- Some of the bigger franchise operations can involve a very large initial cost, often more than what it would cost to start your own business.
- Royalty payments- For as long as one is a franchisee, one will have to pay some percentage of the monthly gross back to the franchisor, reducing one's profit potential.

5. Joint Ventures- A joint venture is a strategic alliance between two or more individuals or entities to engage in a specific project or undertaking. Partnerships of joint ventures can be similar but in fact can have significantly different implications for those involved. A partnership involves continuing long-term business relationships. Whereas a joint venture is based on a single business project.



Advantages

- Provide companies with the opportunity to gain new capacity and expertise.
- Allow companies to enter related businesses or new geographic markets or gain new technological knowledge.
- Access greater resources, including specialized staff of technology.

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Disadvantages

It takes time and effort to build the right relationship and partnership with another business can be challenging. Problems are likely to arise if:-

- The objectives of the venture are not 100% clear and communicated to everyone involved.
- There is an imbalance in levels of expertise, investment or assets brought into the venture by the different partners.
- Different cultures and management styles result in poor integration and co-operation.

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6 THEORIES OF INTERNATIONAL TRADE

LEARNING OUTCOMES

- To understand the various theories of international trade
- To identify the benefits of trade theories

HOW ARE TRADE THEORIES USEFUL?

From profit perspective, it makes sense for any firm to locate its production facilities in countries where cost of production is least. Porter's theory says that a firm has to upgrade advanced factors of production, train employees and invest in R&D. Businesses can lobby with government to adopt policies that have a favorable impact on each component of national diamond.

As firms get involved in international trade, businesses are in a better position to influence government policies and lobby with governments to promote free trade.

International trade is a positive sum game. It benefits all trade partners. Nations pursue either inward (protectionist) trade policy or outward (free) trade policy.

FACTOR ENDOWMENT THEORY

- Simply put, countries with plentiful natural resources will generally have a comparative advantage in making and exporting products using those resources.
- Some countries are relatively well-endowed with capital; the typical worker has plenty of machinery and equipment to assist with the work. In such countries, wage rates generally are high; as a result, the costs of producing labour-intensive goods—such as textiles, sporting goods, and simple consumer electronics—tend to be more expensive than in countries with plentiful labour and low wage rates.

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MERCANTILISM

Countries should export more than they import, and if successful, receive gold from countries that run deficits. Host countries gain from FDI through optimal use of production factors, use of unemployed resources and upgrading of resource quality.

Host countries may lose if investment by MNEs replaces local companies, take the best resources, destroy local entrepreneurship and decrease local R&D undertakings. In the US, local firms complained that Toyota was monopolizing the best workers in the northern Indiana area by paying them higher wages.

FDI affects national development. Cottage industries collapse as MNEs carry out efforts to consolidate local operations. Favorable balance of trade results when companies are exporting more than what they are importing. In the mercantilist period, the difference was made up by transfer of gold.



NEOMERCANTILISM

A country that practices neo mercantilism attempts to run an export surplus to achieve a social or political objective. For instance, a country may try to achieve full employment by

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setting economic policies that encourage its companies to produce in excess of the demand at home and to send the surplus abroad.

A country may attempt to maintain political influence in an area by sending more merchandise to the area than it receives from it, such as government granting aid or loans to foreign government to use for the purchase of the granting country's excess production.

HECKSCHER-OHLIN MODEL

The Heckscher-Ohlin model is a theory that postulates that countries export what they can most efficiently produce in abundance. The theory is used to evaluate the equilibrium of trade between two countries that have different kind of resources. This theory is also called as factor proportions theory.

A country can export those goods where the factors of production are available in abundance. It is wise on the part of nations to import goods that they cannot produce as efficiently as other nations. Countries should export materials and resources that they have in excess and import resources that they need. This will create a balance of trade between nations.

The mathematical model gives an explanation about how a country should operate and trade when there is a global imbalance of resources. The model also extends to labor. Countries that have cheap labor must focus on producing labor-intensive goods.

Experts struggled to find evidence to support the model. Countries in the middle-east have excess oil reserves but have little iron ore. Other countries may have metal resources but they may not have agricultural land. In 2017, Netherlands' exports were $ 506 million while its imports were $ 450 million. Its import-export partner was Germany.

This model explains the benefits of international trade and how it can affect the entire globe. A nation can take advantage of demand that is elastic and it does not have to rely solely on internal markets. As more countries take part in international trade and emerging markets develop, the cost of labor increases and marginal productivity declines.

NEW TRADE THEORY

This theory refers to the ability of firms to attain economies of scale. Economies of scale are unit cost reductions associated with a large volume of output. Due to economies of scale,

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trade can increase variety of goods available to consumers and decrease the costs of these goods. In those industries, when output required to attain economies of scale represents a significant proportion of world demand, the global market may be equipped to support a small number of enterprises. So, the world trade in certain products may be dominated by countries whose firms were first movers in their production.

Let us take an example. Demand for sports car is 55000 units in two markets. The demand for minivan is 80000 units in each national market. A firm in one nation may specialize in producing sports cars. A firm in another nation may produce mini vans. The combined demand for sports cars is 110000 and that for mini vans is 160000 units. This allows each firm to realize scale economies. Trade is thus a positive sum game.

The second point in new trade theory is that pattern of trade we observe in the world economy may be the result of economies of scale and first mover advantages. Economic and strategic advantages that accrue to early entrants into an industry are called as first mover advantages. To sum up, the ability to capture scale economies first is referred to as the first mover advantage.

IMPLICATIONS OF NEW TRADE THEORY

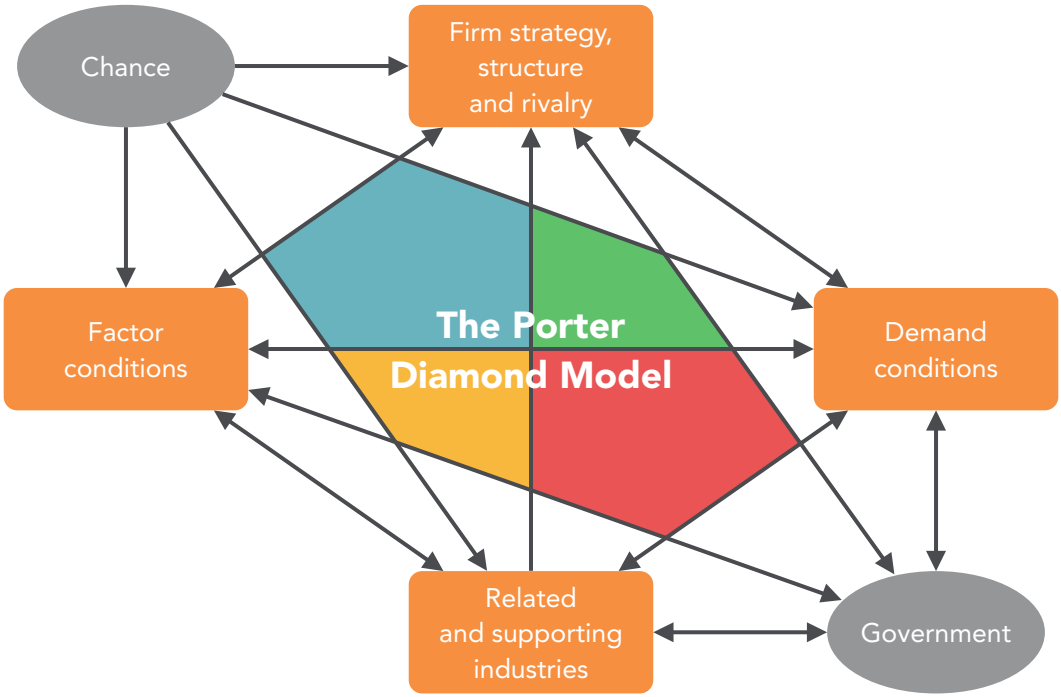
Trade allows a nation to specialize in the production of certain products, attaining scale economies and lowering the costs of producing those products while buying products that it does not produce from other nations that specialize in production of other products. Variety of products is available to consumers in each nation.

The new trade theory suggests that a country may dominate in the export of a good simply because it was lucky enough to have one or more firms among the first to produce that good. First movers are able to gain economies of scale.

PORTER DIAMOND THEORY OF NATIONAL COMPETITIVE ADVANTAGE

Michael Porter designed a model to understand the competitive advantage that nations or groups possess due to certain factors that are available to them. Governments can play a crucial role to strengthen their country's position in the global trade. The economic environment across the globe is becoming more competitive and therefore role of Governments has become more pronounced.

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The model explains that there are some factors that can drive competitive advantage for one national market over another. It describes the sources of a nation's competitive advantage and how this can be achieved. Businesses can use the model to tweak their strategies so that they can successfully operate in different national markets.

Countries can create factors that are conducive to businesses like strong technology, skilled labor and government policies that uplift the economy. While other trade theories downplayed the role of Governments, Porter's diamond theory emphasized on this.

The Porter diamond is a diagram that has four points that determine whether a country will have economic advantage or not. These four factors are

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

Competition triggers businesses to push the envelope and explore ways of increasing production efficiencies and leveraging their capabilities to innovate. The concentration of market power, the extent of competition in the market and the ability of rival firms to enter the market are critical factors. The strategy of a firm has to consider all these factors and ensure that there is a structure to support the strategy.

The presence of upstream and downstream industries that can enable successful innovations can lead to greater degree of transparency and transfer of technology. There can also be risks here – if suppliers become too powerful or customers have a greater competitive choice.

Factor conditions are elements that a country's economy can create for itself like technological innovations, capital, infrastructure and availability of skilled labor. Demand conditions refer to the size of the customer base for products that in turn spurs innovation. More dynamic consumer markets will dictate the need to differentiate and innovate.

Japan achieved competitive advantage much beyond its inherent resources by producing a large number of skilled engineers who could drive technological innovation and engineer a quality movement across the industries.

Porter's point of view is that more than factors like land and natural resources, these four factors will lead a nation to achieve competitive advantage. Governments can create these factor conditions and stimulate competition between domestic companies by framing anti-trust laws.

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Michael Porter tried to explain as to why certain countries excel in particular industries: why are Swiss watches so good and so popular? Why do Italian companies do so well in the tile industry? Porter came up with four attributes of a nation for competitive superiority. According to Porter, the following are the four conditions in a country that make companies at home compete internationally

1. **Demand conditions**: Demand at home makes a company start production at home .This influences the competitiveness of the companies, which they later carry into the overseas market. If the home customers are demanding, the companies would come up with the cost efficiencies, quality enhancements, new product designs and innovative marketing tactics .The confidence that these companies get in doing domestic business, makes them internationally competitive.

2. **Factor Endowments**: A good endowment of certain factors of production would result in the nation having competitive advantage with respect to other less endowed nations

   Example: USA has large phone coal reserves, so it has a natural competitive advantage in the chemicals industry. According to Porter there is a basic factor endowment and advanced factor endowment.

   Basic factor endowment: Natural resources, land, water, minerals, location, climatic conditions

   Advanced factor endowment: Availability of skilled and educated workforce, technological research and development facilities, telecommunication and transportation

   Therefore government can provide incentives to the development of skills and educational levels in the country.

3. **Related and supporting industries:** Competitive advantage of an automobile industry is enhanced if supported by a competitive steel industry .Good effects of one industry tend to spill over into another related industry. A good textile industry in India would help the Indian garments industry .If there is a group of industries that are internationally competitive and mutually supportive, it enhances the competitiveness of the entire group of industries

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The mutually beneficial results are:

a. Reduced transport cost of inputs
b. Readily available large market for the products
c. Technology spillover effects

4. **Firm strategy, structure & rivalry:** Firms in a country are characterized by management strategy typical of the country. Japanese known for manufacturing, Germans are famous for engineering and Americans for research and development .Thus Americans will tend to lag behind Japanese when it comes to JIT and Lean manufacturing. But America will be tops when it has got to do with the design and development and introduction of new product into the market.

Porter says that strong domestic competition is important for the emergence of international competitiveness. All these four determinants are mutually interacting

1. Unless the demand conditions are favorable, the factor endowments will not produce the competitive advantage.
2. Unless domestic rivalry exists sufficiently the demand conditions will not result in competitive advantage.
3. If supporting industries do not exist adequately, a nation will find it difficult to develop competitive advantage.

The two variables that would influence the national diamond significantly are 'chance events' and 'government'. Innovations are one such 'chance' event. Government support is another variable because this will influence domestic rivalry, domestic advanced factor endowments and domestic demand conditions

Porter's diamond looks at international trade from a national strategic perspective .It hints at actions that governments could take in order to boost their country's trade with other Nations .Again the question arises- If competitive advantage of a nation and its industry can be redesigned by the government's intervention, would it amount to hindering 'free' trade?

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LIMITATIONS OF PORTER'S DIAMOND

1. It is not always necessary to have all the four determinants for a nation to have developed the competitive advantage.

2. Porter's diamond says rigorous competition at home is essential .In case of India's Software Industry there is not much competition for markets at home, the market for software is more in West than in India (as on 2019, situation has changed completely as banks are aggressively and adapting CBS core banking solutions, software for which is produced by Infosys, Wipro, Cognizant etc. But the truth is that the growth of software industry can be attributed more to growth of international markets.)

   Factors of production are getting more mobile, spread of technology across nations is vast, information availability is faster and the demands of international customers are getting fulfilled. Therefore, the concepts of local demand, local factor endowment, local competition etc. seem to be getting outdated.

   Lakshmi Mittal did not develop the large steel industry in India .His company 'Ispat' Industries is quite small compared to Mittal's Steel Empire at a global level.

   There is also one more incongruity in Porter's theory - with globalization, firms in different countries are trying to customize their products and services and it is not necessary that firms have to sell the same products in the home country and host country unless they have what is called as International strategy.

PRODUCT LIFE CYCLE THEORY

It is an economic theory developed by Raymond Vernon as the Heckscher-Ohlin model could not explain the observed pattern of international trade. Early in a product's life cycle all the parts and labour associated with that product comes from the area in which it was invented. After product is adopted and used in world markets, production moves away from the point of origin.

In some situations, the product becomes an item that is imported by original country of invention. There are four stages in a product life cycle

1. Introduction
2. Growth
3. Maturity
4. Decline

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Stage 1: New products are introduced to meet local needs; new products are first exported to similar countries (countries with similar needs). Products are introduced in the most advanced nations.

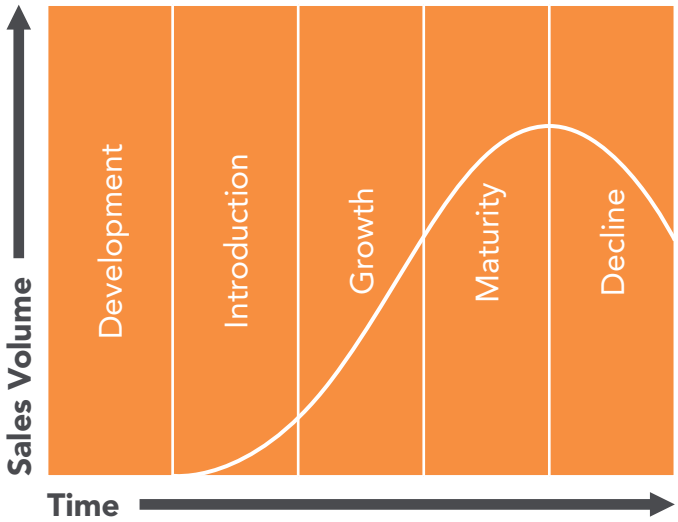
Stage 2: Copy product produced elsewhere and introduce in home country and elsewhere to capture growth in home market. Production is then moved to other countries.

Example – Xerox Photocopiers were introduced in USA in 1960. Then they were exported to advanced countries like Japan and Western Europe. There was a further growth in demand. This necessitated the setting up of joint venture production: Fuji-Xerox (Japan) and Rank-Xerox (Great Britain). After a few years, Xerox's patent expired. This paved the path for entry of competitors like Canon (Japan) and Olivetti (Italy). Finally, US had to import from low cost sources (read: developing countries).

Stage 3: Maturity: Industry contracts and concentrates. The lowest cost producer wins here.

Stage 4: Decline: Poor countries constitute the only markets for the product. All declining products are produced in least developed countries.

Raymond Vernon proposed this theory in the 1960s. Many new products were developed and sold in the US market (mass production). The wealth and size of the US market gave the firms a strong incentive to innovate and develop new consumer products. Due to high cost of labour in US, firms started developing cost saving process innovations. They decided to keep production facilities close to the market. Businesses wanted to be close to the firm's decision making nerve center. There was uncertainty and risks inherent in introducing new products. Firms charge high prices for new products. Therefore, there is no need to look for low cost production sites in other countries.



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Early in the life cycle of the new product, demand grows fast in the United States, but demand in advanced countries is limited to high income groups. As firms in these countries won't make such products due to limited demand, this makes it easier for a country like US to export.

As time passes, demand for the new product grows in other advanced countries (example – Great Britain, France, Germany & Japan). So, foreign producers start producing for home country markets. US firms might set up production facilities in those advanced countries where demand is growing. Due to production in other countries, exports from US start declining.

The markets mature. Products become more standardized. Price becomes a competitive weapon. So, achieving cost efficiency becomes essential. Producers in advanced countries where labor costs are lower than US will start exporting to US. If cost pressures become intense, developing countries like Thailand begin to acquire a production advantage over advanced countries.

The locus switches from US to other advanced nations and from them to developing countries. Over time, the US switches from being an exporter of product to importer of product. This is the Product Life Cycle Theory.

DRAWBACKS OF VERNON'S THEORY

Vernon's argument that most new products are developed and introduced in the USA seems ethnocentric. Many new products are now introduced in Japan and Europe. India and China are not lagging behind either. A growing number of new products are now introduced simultaneously in the US, Japan and advanced European nations.

THEORY OF ABSOLUTE ADVANTAGE

Adam Smith is regarded as the father of modern economics. He said that countries should only produce goods that they have an absolute advantage in. A country has an absolute advantage if the country can produce a good at a lower cost than another. Fewer resources are needed to provide the same amount of goods as compared to other countries. This efficiency in production creates an absolute advantage.

Let us now look at the assumptions in the theory of absolute advantage

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1. **Lack of Mobility for Factors of Production**
   Factors of production cannot move between countries.
2. **Trade Barriers**
   Trade barriers are created by Government to restrict imports and exports of a particular good.
3. **Trade Balance**
   No trade imbalances or trade deficits or surpluses exist. Exports must equal imports.
4. **Constant Returns to Scale**
   There are no economies of scale. As production scales, we will get constant returns. It makes sense from businesses and countries to trade with one another. All countries engaged in open trade benefit from lower costs of production.

THEORY OF COMPARATIVE ADVANTAGE

Comparative advantage results when a country produces a good or service for a lower opportunity cost than other countries. A nation with a comparative advantage makes the trade-off worth it. The country may not be the best at producing a good but the good production may have a low opportunity cost for other countries which encourages them to import the goods.

Saudi Arabia, Kuwait and Mexico have a comparative advantage over USA when it is a case of manufacture of chemicals. The cost of production is low and so the opportunity cost is low. India's call centers are cheaper for companies in the USA. Earlier comparative advantages occurred more in goods and rarely in services. Internet has made it easier to export services.

Eighteenth-century economist David Ricardo proposed the theory of comparative advantage. According to him, a country boosts its economic growth by focusing on the industry in which it has the most substantial comparative advantage.

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For example, if England could manufacture cheap cloth then Portugal could manufacture cheap wine. Ricardo predicted that England would stop making wine and Portugal stop making cloth. England and Portugal benefited by trading.

This theory of comparative advantage became the basis for free trade agreements. It argues against trade protectionism. Political leaders are under pressure from domestic industry to protect jobs and restrict imports. But this can only be a temporary solution. In the long run, the tariffs will end up hurting the nation's competitiveness. A nation's resources get wasted on industries that are not so successful. Consumers are forced to pay higher prices to buy goods that are locally produced.

One of the most controversial contributions to the literature of international trade theory was proposed by the late social economist John Culbertson.

According to Culbertson, low wage competition among corporations undermines the theory of comparative advantage. Today, capital is mobile and trade deficits exist. International trade with China, India and Vietnam will be governed by absolute advantage.

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7 WORLD TRADE ORGANISATION & TRADE LIBERALISATION

LEARNING OUTCOMES

- To examine the aims and functions of World Trade Organisation
- To identify the functions of World Trade Organisation
- To learn about the underlying principles of WTO
- To understand the differences between GATT and WTO

INTRODUCTION

WTO stands for World Trade Organisation. It was founded in 1994 to police the world trading system established by the General Agreement on Tariffs and Trade. The WTO arbitrates trade disputes between 148 states that are signatories to GATT. The arbitration panel can issue a ruling instructing a member state to change trade policies that violate GATT regulations. If the violator refuses to comply with the ruling, the WTO allows other states to impose appropriate trade sanctions on the transgressor. Headquarters of WTO located in Geneva.

The Uruguay round of trade negotiations conducted from 1986 and got over in 1994. WTO started on 1.1.1995. The rules of WTO are provided by GATT – General Agreement on Tariffs and Trade.

WTO is a supra national organization that has powers and influences that transcends national boundaries. WTO exists to serve collective interests of member states. The power of WTO lies on its ability to persuade member states to follow a certain action. If WTO fails to serve the collective interests of member states, then the latter will withdraw their support and a supranational organisation like WTO will collapse.

The aim of WTO is to promote international trade without any discrimination.WTO promotes free trade among nations by limiting the abilities of national governments to adopt policies that restrict imports into their nations. WTO plays the role of the watchdog in the spheres of trade in goods, trade in services, foreign investment and intellectual property rights

India is one of the founder members of WTO.

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MFN clause – Most favored Nation – The member countries should give equal treatment to the products imported from any other member country. Countries cannot discriminate between their trading partners.

National Treatment clause – Member country should treat the foreign products once they enter their country exactly equal to those of similar domestic products. Treat foreigners and locals equally.

The national treatment applies only after a good has crossed the nation's border. If an item is charged an import tariff, it does not mean that similar item made locally would be charged equivalent tax. What it means is that the tariff reductions committed to are not nullified through a back door procedure of imposing additional taxes.

Together the principles of MFN and National Treatment provide fair conditions of trade. They also provide a stable and predictable regulatory environment for trade.



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FUNCTIONS OF WTO

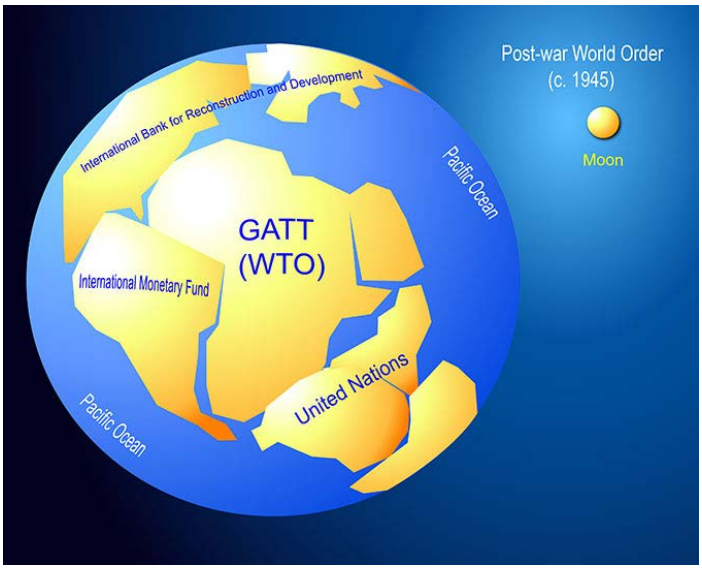
1. It is a forum for trade negotiations.
2. It administers trade agreements. Agreements have little meaning unless they are implemented.
3. It ensures that trade flows freely, without any hitch, in accordance with the set rules.
4. It oversees implementation of tariff cuts and reduction of non tariff measures agreed in the trade negotiations
5. It ensures that individuals, companies and governments know what the trade rules are around the world.
6. WTO resolves trade disputes. General Council of WTO meets as the Dispute Settlement body. There is a dispute settlement procedure along with time limits.
7. WTO also oversees national trade related policies. Governments have to inform WTO and fellow members of policies or laws through regular notifications; WTO conducts regular reviews of individual countries' trade policies,.
8. The general council of WTO meets. The member country's government provides its policy statement. WTO gives a detailed review report for the benefit of all member countries. The reviews take into account the wider ramifications to member countries' economic and development needs and the general economic environment. There is an element of peer review or multi lateral assessment in this procedure; this puts peer pressure on the member governments to fall in line and follow the WTO rules. This lends transparency to the entire WTO functioning and enhances the quality of multi lateral discussions and negotiations.
9. WTO acts like a management consultant for world trade. Economists of WTO observe the pulse of the global economy and provide studies on the main trade issues.
10. It helps developing countries in the implementation of Uruguay round of negotiations.
11. WTO also co-operates with other international organizations like IMF and WB so that there is more coherence in the world economy.



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PRINCIPLES OF WTO

a. Trade without discrimination :
b. There is predictability in international trade through binding commitments.
c. Trade disputes resulting due to reneging on commitments are taken up by Dispute Settlement Body whose decision is final. Thus WTO emphasizes rules of the trade and makes the international trade environment more predictable. By reviewing trade policies of member nations, WTO acts pro actively.
d. WTO aims to bring down the barriers to trade – tariff and non tariff gradually through multi lateral negotiations.
e. WTO strives to establish fair competition. It sets rules on what is fair, what is unfair
f. WTO is committed to addressing issues that confront developing nations. WTO is interested in encouraging development all around the world.



Source: http://www2.econ.iastate.edu/classes/econ355/choi/gatt.htm

TRIPS

Trade related intellectual property rights (TRIPS) was proposed by Dunkel. These cover protection ofPatents, copy rights, design, trademarks and trade secrets. Earlier process patents were given to food,medicines, drugs and clinical products. From 1st January 2005, the TRIPS agreement grants productpatents. India, Brazil and China advanced their deadline to meet TRIPS commitments. Protection will beavailable for 20 years for patents and 50 years for copyrights. Trademarks will be protected for at leastseven years.

Trade mark is a symbol, word, or words legally registered or established by use as representing company or product.

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TRIMS

Trade related investment measures – removal of various controls imposed on the inflow of foreign capital into the third world countries. MNCs will be treated as national companies. The foreign capital would not be discriminated by the member governments.

The features of TRIMS are:

a. Abolition of restrictions imposed on foreign capital
b. Equal rights to foreign and domestic investors
c. No restriction on any areas of investment
d. Participation of foreign equity shall be allowed up to 100%
e. Grant permission for FDI without restrictions on import of raw materials.
f. Export of final product shall not be made mandatory
g. Restriction on repatriation of dividend, interest and royalty will be removed.
h. Manufacturing program in phases

The organisation structure of WTO comprises four hierarchies – ministerial conference, general council, councils, committees and management bodies.

URUGUAY ROUND OF NEGOTIATIONS

Draft proposal by Arthur Dunkel, the then Director General of GATT, include market, agriculture, TRIPS and TRIMS and Trade in Services. Market – Member governments have to abolish the public distribution system.



Fig : Arthur Dunkel

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Agriculture – member governments have to reduce the subsidy on fertilizers, seeds and eliminate the administered pricing in agriculture sector. WTO members abolished quotas on trade in textiles and clothing on 1.1.2005. Dunkel proposed green policies for expenditure by government on disease control, environment protection, food security and expenditure for expansion of infrastructure.

As regards textiles, competition is sharper, with successful textiles and clothing producers setting new standards of service. Some strategies were proposed for textile firms like product specialization, cross border co-operation with least developed countries (LDCs). LDCs had to improve their sourcing skills and focus on higher value products. Inter regional cooperation among nations for developing joint production and linking production and marketing.



Mega textile companies should invest in Africa. African countries produce raw cotton but they did not have domestic industries to transform cotton into yarn and cloth on a scale that can meet export needs.

Besides this, Uruguay round discussed TRIPS related to protection of copyrights, trademarks, patents, trade secrets. They also discussed TRIMS wherein the foreign capital would not be discriminated by the member governments. General agreement on trades in services (GATS) provides a multi lateral framework of principles and services.

WTO is the only multilateral forum to discuss trade liberalizations and settle disputes. WTO's dispute settling mechanism is good. WTO covers most favored nation, national treatment, reciprocity of trade concessions, trade liberalization, transparency and predictability in import and export rules and regulations ; favorable treatment to countries that are less developed.

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WTO & ANTI DUMPING MEASURES

Dumping is the sale of goods abroad at a price which is lower than the selling price of same goods at same time in the same circumstances at home.

THREE TYPES OF DUMPING

Intermittent – Production in home country more than demand

Persistent – Monopolist sells remaining production in foreign countries at low price on a continuous basis.

Predatory - Monopolist sells product in foreign market at low price, drives competition, then increases the price after competitors leave the market.

Dumping is carried out to enter foreign market, to sell surplus production, develop trade relations. The importing country experiences a decline in sales and profits. When China dumped steel in India, Indian steel industry faced deflationary situation and decline in sales.

Cooking oil was dumped by USA and Malaysia in India, so the government had to impose anti dumping tariff. Consumers of exporting country pay a higher price for the same product. The exporting country finds a market for the excess production and earns foreign exchange which actually improves its balance of payments position.

Anti dumping measures are charging high rates of tariff duty, restricting volume of imports by having a quota and import embargo (ban import of particular goods or all goods from the dumping country). The exporting countries voluntarily come for bilateral agreements to avoid dumping. WTO carries steps to investigate anti dumping measures. Quotas and controls are called as Non tariff barriers.

The 3 main instruments of WTO are GATS, GATT and TRIPS (Trade related Intellectual Property rights).

WTO – EMERGING ISSUES

WTO found out that patent rights of pharmaceutical companies will deprive the poor and third world countries and developing nations from having access to drugs that are cheap.

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So, in the year 2002, in the Doha round of talks, TRIPS was asked to come out with a solution. All members agreed on the following points that were proposed:

- Poor countries will have access to cheap drugs to fight killer diseases
- Poor countries have to obtain a license
- Countries producing generic copies of patented drugs can export such drugs to eligible importing countries
- Exporting country has to inform TRIPS council about exports and pay adequate remuneration to patent holder.

Indian pharmaceutical sector felt that this was good for poor countries and drug companies in India and Brazil would benefit by enhancing their exports.

Ministerial Conference	Location
First	Singapore, 1996
Second	Geneva, 1998
Third	Seattle, 1999
Fourth	Doha, Qatar, 2001
Fifth	Mexico, 2003
Sixth	Hong Kong, 2005
Seventh	Geneva, 2009
Eighth	Geneva, 2011
Ninth	Indonesia, 2013
Tenth	Kenya, 2015
Eleventh	Argentina, 2017
Twelfth	Scheduled to be held in 2020 in Kazakhstan

The Doha declaration called for negotiations on reduction in industrial tariffs, phasing out agriculture subsidies, promoting services, special treatment for developing countries, negotiations for setting up a multi lateral agreement on transparency in government procurement, clarification of disputes settlement. As per the TRIPS agreement, member countries have the right to issue compulsory licenses; determine what national emergency is in the fight against AIDS; Grant licenses for domestic production of drugs essential to fight health crisis.

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The WTO committee was given a period of 1 year within which the final recommendations on dealing with anti dumping issues will be made to the General Council.

India was happy with the Doha declaration for the flexibility provided for protection on grounds of food security, rural development and declaration of TRIPS, which put public health before patents. India refused to agree to the strategies worked out by EU, US & Japan. India decided to oppose the ministerial declaration over the proposed negotiations on investment, competition policy, transparency in government procurement and trade facilitation. India succeeded in its efforts at the Doha declaration.

China was admitted to the WTO in November 2001 and agreed to implement TRIPS ahead of deadline of 2006.

In the 5th ministerial conference at Mexico, discussion centered around high agricultural subsidies offered by EU, USA that caused distortion of trade because these agricultural products were cheaper in the world market as compared to the products offered by developing countries. The US and EU agreed to reduce agricultural subsidies gradually. The US and EU demanded that foreign companies be treated on par with domestic companies in developing countries. But the latter rejected this demand. The proceedings at Mexico made the developing countries come closer.

23 developing countries including India, China, Brazil, South Africa formed G+.

In the Hongkong conference, some of the important issues decided were:

- Elimination of all forms of agricultural export subsidies by 2013
- Take care of special needs of developing countries
- Reduce or eliminate tariffs on those products that developing countries want to export
- There has to be more market access for developing countries for agricultural and non agricultural products,
- Promotion of services
- Use TRIPs to promote health in developing countries
- Continuous trade negotiations to solve the conflicts mutually among countries
- Resolve to resolve disputes using dispute settlement body and trade negotiations committee
- Least developed countries would be guaranteed from 2008 for duty free, quota free access for 97% of their exports.

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In the 6th ministerial conference in Hong Kong, the WTO member countries, some pressured strongly by foreign economic and political interests, presented a common Ministerial Declaration. Poor countries conceded to rich countries' interests in freeing trade in industrial goods and services in exchange for some concessions on export subsidies for agricultural goods. The European Union promised to eliminate export subsidies by 2013.

The Seventh Session of the WTO Ministerial Conference in Geneva, Switzerland, took place from 30 November to 2 December 2009. The general theme for discussion was "The WTO, the Multilateral Trading System and the Current Global Economic Environment".

The Eighth Ministerial Conference was held in Geneva, Switzerland, from 15 to 17 December 2011. In parallel to the Plenary Session, where Ministers made prepared statements, three Working Sessions took place with the following themes: "Importance of the Multilateral Trading System and the WTO", "Trade and Development" and "Doha Development Agenda". The Conference approved the accessions of Russia, Samoa and Montenegro. In the final session, Ministers adopted a number of decisions and the Chair made a concluding statement

In his concluding remarks on 7 December 2013, at the end of the WTO's Ninth Ministerial Conference in Bali, Director-General Roberto Azevêdo thanked WTO members for showing "the political will we needed to take us across the finish line. With the Bali Package, you have reaffirmed not just your commitment to the WTO — but also to the delivery of the Doha Development Agenda."

The WTO's Bali Ministerial Conference concluded a day later than scheduled on 7 December 2013 with agreement on a package of issues designed to streamline trade, allow developing countries more options for providing food security, boost least developed countries' trade and help development more generally.

The WTO's 10th Ministerial Conference was held in Nairobi, Kenya, from 15 to 19 December 2015. It culminated in the adoption of the "Nairobi Package", a series of six ministerial Decisions on agriculture, cotton and issues related to least-developed countries (LDCs).

India was unhappy with US' refusal to agree on the public stockholding issue at the 11th ministerial conference in Buenos Aires. India was supported by over 100 WTO member countries on all the agricultural issues. The 53-member African Group as well as a large number of developing countries have supported India in opposing rules on e-commerce and bringing in new issues such as investment facilitation and MSMEs into the WTO's agenda.

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IS WTO PRO-RICH?

In the initial few ministerial conferences, it appeared that WTO was pro rich. But in the 2nd conference at Geneva, WTO aspired to raise the living standards of people in the entire world. The 3rd conference at Seattle was controversial. Developing countries felt that rich countries were imposing their views on poor countries. There was pessimism about free trade as a solution for all economic problems.

Transparency and accountability was only for developing countries and not developed nations. Why? WTO was criticized as caring little for Asian, African and Latin American countries. Demonstrators at Seattle said that WTO was Wrong Trade Organisation as developing countries were exploited by developed countries under the pretext of globalization. America did not agree on inclusion of labor standards. The European Union was reluctant to cut down on heavy agricultural subsidies.



But from the 4th conference at Doha onwards the situation started changing. WTO began discussing about interests of developing countries. Declaration of TRIPS and public health taking precedence over patents – these were positive signals. In the 5th conference at Mexico, developed nations like US and Europe insisted on covering the negotiations started in Singapore in the first conference. These include foreign investment, domestic competition policy (dealing with monopolies and cartels), transparency in government procurement and trade facilitation by custom procedures. Though these discussions failed, developing nations joined hands. The feeling that WTO was not doing anything concrete was put to rest when some actions were taken in the 6th ministerial conference at Hong Kong.

Considering the above, though WTO appeared to be pro-rich initially, it has proved to be pro-poor as reflected in the proceedings of the subsequent ministerial conferences. But it still has a long way to go before it proves that it is really pro poor. This is because rhetoric is something, action is something else.

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INDIA & WTO

India was the founder member of WTO. GATT had estimated that merchandise trade would be much greater in clothing, agriculture, forestry and fishery products, processed foods and beverages. India is expected to gain a lot from such trade. Due to removal of barriers in exporting of agricultural goods, agricultural exports from India will increase. Rules regarding anti dumping, subsidies and disputes settlement were favorable for India. India got access to a number of developed nations. Ending quota system in world textile trade was good news for India. India has adopted the product patent regime for food, drugs and chemicals from 1st Jan 2005.

DRAWBACKS FOR INDIA

In bilateral trade, you give concessions to one country and get concessions from the same country. In multi lateral trade, you have little to give all nations and so little to get from them too. Introduction of product patents in India will lead to MNCs hiking the drug prices which will hit the poor people. The extension of intellectual property right to agriculture has negative effects on India. Through scientific research, Indian scientists undertake plant breeding and seed production. Government gives seeds to Indian farmers at low prices. In future, Indian scientists will find it difficult to breed new varieties as they will be denied access to patents. MNCs will start having control over food production.

Take the case of Syngenta, an US firm that has a plant in Goa that sells fertilizers to Indian farmers. In the last few years, there has been so much reporting on the use of fertilizers in agriculture that are more than what is actually needed. Application of TRIMS also impacts a country's ability to be self reliant.

Inclusion of trade in services is not a good sign. We are already seeing the impact of it. Mc Donald's, Pizza Hut, Star Bucks, Kentucky Fried Chicken are all dominating the Indian market. Services sector in India is as much as 57% of GDP. Isn't this incongruence in a country like India which is predominantly an agricultural nation?

India has always played an active role like a leader in WTO. Indian team members have been tough negotiators. Several developing countries look to India for leadership. It also plays an integrative role for balancing the interests of the developed and developing nations.

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INDIA AND DUMPING

After India reduced tariff on imports and implemented the MFN clause, China and East Asian countries started dumping consumer goods, consumer durables and agricultural products. Chinese products were also priced lower. China is price competitive because of low labour cost and high labor productivity. Foods and soaps were imported from Thailand, chocolates dumped from Malaysia, coffee mix and nutritional drinks dumped by Singapore, juices and crockery by Sri Lanka. USA & EU were dumping agricultural products that hurt the Indian farmers. USA and Malaysia were dumping cooking oil in India, selling rice at Rs 6 per kg and coconuts at Rs.1. The Government was in a dilemma whether to protect the Indian consumer or the Indian farmer.

On the positive side, this is a signal for domestic industry that it should not bank on protection for too long. They have to compete in the market on their own strength by improving productivity, increasing production, reducing cost of production. India's agricultural sector should get rid of its incompetence's and inefficiencies to counter dumping. India played a leading role in the 4th and 5th ministerial conferences and opposed the demand for reducing import duties on agricultural products. India also played a role in deferring the negotiations on investment, transparency of government procurement and other issues raised in the Singapore conference.

The WTO membership is good for India, in terms of global market thrown open to its goods and services. India has to strengthen its position to sell products abroad. Improve the quality of our goods and services, reduce costs, wastage and improve our competitive strength.

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DIFFERENCES BETWEEN GATT & WTO

GATT	WTO
General Agreement on Tariffs and Trades	World Trade Organisation
No legal status	Legal status
Set of rules and procedures relating to multi lateral agreements that are not binding	Agreements of WTO permanent and binding on all members
Dispute settlement slow, not binding on parties	Dispute settlement mechanism faster, binding on all parties
Decisions not time bound	Decisions are time bound
Covers trade in goods ; decision on trade in services still pending	Covers both trade in goods and services
GATT has a small secretariat office	WTO has a large secretariat & huge organizational set up

WHY DO WE NEED WTO?

Governments have international political objectives. International trade can affect the international political scenario. Free trade is a desired objective, but the world is made up of sovereign political states having their national and international goals and programs. It is to balance the pulls of 'nationality' and the need for 'free trade' that an organization like WTO exists.

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8 REGIONAL TRADE BLOCKS

LEARNING OUTCOMES

- To examine the significance of Regional Trading Blocs
- To identify the different types of regional trade blocs

INTRODUCTION

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 represent a special type of economic integration and shape the pattern of world trade.

Trade integration across countries is intensifying. Regional trade blocks are arrangements aimed at faster trade liberalization at regional levels.

Today countries acknowledge that trade is an engine of economic growth and they are in constant search for arrangements that facilitate expansion of trade. The World Trade Organisation represents a multilateral forum for trade liberalization. As interests of a large number of countries conflict with one another, scope of trade liberalization is getting restricted. So, there is renewed interest in trade liberalization among countries that are regionally close together. This has necessitated the need for more tariff cuts and removal of trade and non trade barriers among these nations. The slow pace of trade liberalization within the WTO is what has led to the formation of regional trade blocks. Recurring economic recessions have also led to the formation of regional trade blocks.

Regional Trade Blocs or Regional Trade Agreements (or Free Trade Agreements) are a type of regional intergovernmental arrangement. Here the participating countries agree to reduce or eliminate barriers to trade like tariffs and non-tariff barriers.

European Union, North American Free Trade Association, ASEAN are examples of regional integration. North America, Western Europe and Asia Pacific have the most successful trade blocs. India has signed many bilateral free trade agreements.

All regional trade blocs do not have the same degree of trade liberalization. They may differ in terms of the extent of tariff reductions, coverage of goods and services and agreement on movement of labour. Free trade area is a trade bloc where a group of countries agree to

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eliminate tariffs, quotas and preferences on most goods and services traded between them. Free trade agreement is most common wherein the members abolish tariffs within the region.

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

- **Preferential Trade Area** – Preferential Trade Areas (PTAs) exist when countries in a particular geographical region agree to decrease or eliminate tariffs on selected goods and services imported from other members of the area.
- **Free Trade Area** – Here, the participating countries agree to remove or reduce barriers to trade on all goods coming from the participating members. Member countries maintain their individual tariffs against the rest of the world.
- **Customs Union** – A customs union has no tariff barriers between members. They also agree to a common (unified) external tariff against non-members. The members are allowed to negotiate as a single bloc with third parties, including other trading blocs, or with the WTO. These countries adopt a common external tariff against the rest of the world.
- **Common Market** – Here, the member countries trade freely all types of economic resources – not just tangible goods. All barriers to trade in goods, services, capital, and labor are removed in common markets. In addition to tariffs, non-tariff barriers are also diminished or removed in common markets. This involves unrestricted movement of all factors of production including labour between the member countries. For a common market to be successful there must be harmonization of micro-economic policies and common rules regarding monopoly power and other anti-competitive practices.
- **Economic union** - The Economic Union is the highest form of economic co-operation. This arrangement is characterized by common currency, common fiscal and monetary policies and exchange rate policies etc. European Union is the example for an Economic Union.

REGIONAL TRADING BLOCS – ADVANTAGES

As members know that they have free access to each other's markets, they are encouraged to specialize. Trade between member nations increases as there is easy access to each other's markets. Free trade enables high cost domestic producers to be replaced by imports that cost lower. This fuels the demand.

Producers can benefit from the application of scale economies, which will lead to lower costs and lower prices for consumers. Jobs are created as a result of increased trade between member economies.

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Firms inside a trading bloc are protected from cheaper imports from outside, such as protection of the EU shoe industry from cheap imports from China and Vietnam. There is a rise in foreign direct investment in member nations and this boosts the growth in GDP. As there is greater competition between firms, it results in increased production efficiencies.

Trade blocs result in decreased cost of imports leading to a wide variety of products for consumers. Increased consumption, changes in demand and a large number of products lead to a market that is efficient.

REGIONAL TRADING BLOCS – DISADVANTAGES

During the 1970s many former UK colonies formed their own trading blocs when UK joined the European common market. Development of one trading bloc can lead to formation of other blocs. Trade disputes arose between the EU and NAFTA. The EU and the US have had a long history of trade disputes. The US steel tariffs were declared as illegal by the WTO in 2005.

Due to the emergence of trading blocs, the benefits of free trade between countries in different blocs are lost. Trading blocs can lead to distortion of world trade. Inefficient producers within the bloc can be protected from more efficient ones outside the bloc. Trade diversion results when trade is diverted away from efficient producers who are based outside the trading area.

Trading blocs have a bias in favor of their member countries. These economies establish tariffs and quotas that protect intra-regional trade from outside forces. When a trading bloc becomes a political union, it leads to partial loss of sovereignty of the member nations. The countries of a bloc become interdependent on each other. The RTB countries would let non-member firms gain access to their domestic market only after levying taxes.

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9 EUROPEAN UNION

LEARNING OUTCOMES

- To understand the history and growth of European Union
- To review the challenges faced by European Union

INTRODUCTION

The European Union (EU) comprises a group of 28 countries that operates as a cohesive economic and political bloc. 19 countries use the euro as their official currency. In a 2016 referendum, the U.K. voted to leave the EU. Brexit has been challenged repeatedly. The EU governs common economic, social and security policies of its member states. The capital of the European Union is Brussels, Belgium. The European Union is run by five main bodies: European Parliament, Council of the Union, European Commission, Court of Justice, and the Court of Auditors. As of January 2017, an estimated 511.8 million people lived within the EU. The United States is the European Union's main trading partner.



The European Union ensures that its members have access to state of the art technologies. Research and development, energy and environmental protection are high priority areas. A product manufactured in one country can be sold to any other member without tariffs or duties.

Practitioners of most services, such as law, medicine, tourism, banking, and insurance, can operate in all member countries. This has led to a fall in the cost of airfares, the internet, and phone calls.

The EU aims to be competitive in the global marketplace and also balance the needs of its fiscal and political members. Each year European countries that are part of EU agree on

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a budget. This covers expenditure on agricultural support and regional development. The initial budgets are reviewed by ministers from the various countries.



WHY WAS THE EU FORMED?

There was a desire to form a single European political entity so that the warfare among European countries could be brought to an end. The Word War II had decimated much of the continent. The European Single Market was established by 12 countries in 1992 to ensure freedom of movement of goods and services, freedom of movement of people and money.

In 2017, the European Union's GDP was $ 17.1 trillion. This increased to $ 18.8 trillion in 2018.

TRACING THE HISTORY AND GROWTH OF THE EUROPEAN UNION (EU)

The EU began as the European Coal and Steel Community, which was founded in 1950 and had just six members: Belgium, France, Germany, Italy, Luxembourg, and the Netherlands. It became the European Economic Community in 19957 under the Treaty of Rome and, subsequently, became the European Community (EC).

The EU began in 1950 as the European Coal and Steel Community with six members namely Belgium, France, Germany, Italy, Luxembourg and the Netherlands. In 1957 it became the European Economic Community and subsequently it was called the European Community. In the initial days, EC focused on agricultural policy as well as the elimination of customs barriers. The EC expanded in 1973 when Denmark, Ireland, UK, Greece and Spain became members. The European Parliament took office in 1979.

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In 1986, the Single European Act was framed to operationalize the principles of foreign policy cooperation. The powers of the community were extended over the members. The act formalized the idea of a single European market.

Following the Maastricht Treaty on November 1, 1993, the European Union (EU) replaced the EC. The treaty created the euro, the single currency for the EU. The euro debuted on January 1, 1999. Denmark and the United Kingdom were permitted them to retain their own currencies.

The EU and the European Central Bank faced issues of high sovereign debt. Following the global economic crisis in 2008, Portugal, Ireland, Greece and Spain faced de-growth of their respective economies. In 2009, Greece and Ireland received financial bailouts followed by Portugal in 2011.

There was a North-South divide in the EU. The problems did not get resolved despite interest rate cuts and other fiscal measures by the EU. Northern countries such as the UK, Germany and Netherlands dissented against the financial drain to protect the interests of the Southern Region.

BREXIT

The crisis in EU moved to stagnation. On June 23, 2016 the UK government announced that it would hold a referendum to examine whether it would remain a part of the EU. The nation voted to leave the EU. The Brexit plan has been challenged by various coalitions of the UK Parliament.

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Due to its trade structure, EU is considered the world's second-largest economy after China. The EU's success is considered uneven. Italy, Greece and Cyprus have nonperforming assets, public and private debt. These countries have a high rate of unemployment. France has issues of low productivity. Germany has a large trade surplus. Many countries in EU need reforms of their pension systems and labor markets.

US companies are the largest investors in Great Britain. Many in the UK were concerned about the free movement of immigrants and refugees. They resisted the budgetary constraints and regulations imposed by the EU. They desired the benefits of free movement of capital and trade but rising costs were unacceptable to them.

In 2015, 1.2 million refugees from Africa and the Middle East entered Europe's borders. On New Year's Eve 2016, gangs of young refugees across Germany robbed, injured, and sexually assaulted more than 1,200 people, primarily women. This led to EU countries sealing off their borders. 8000 immigrants were stranded in Greece. The EU signed an agreement with Turkey to take back refugees who had reached Greece. In return, the EU would pay 6 billion euros to Turkey. Immigration is the main reason why UK voted for exiting the EU.

On January 15, 2019, the U.K. Parliament rejected Prime Minister Theresa May's "Withdrawal Plan" forcing her to come up with an alternative by January 21. On March 27, when the most recent Brexit vote was held, none of the eight Brexit alternatives voted on by Members of Parliament received a majority. Theresa May's deal was rejected again on March 29 by a margin of 58 votes, despite her vow to resign before the next stage of negotiations if it was passed. Currently, the EU and UK have agreed to delay Brexit until Oct. 31, 2019.

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10 BREXIT

LEARNING OUTCOME

- To understand the business implications of Brexit

On 23rd June 2016, Britain voted to leave the European Union. The value of the pound dipped after this announcement. It is expected that UK's exports will be adversely affected. For example – a manufacturer in the UK may rely on raw-materials from Germany, but since free trade between UK and EU is no longer valid, the cost of supplies will rise. Critics say that businesses in the UK will become less competitive in the EU.

Brexit is an abbreviation for "British exit," referring to the U.K.'s decision in a June 23, 2016 referendum to leave the European Union (EU). Former Prime Minister David Cameron, who called the referendum and campaigned for Britain to remain in the EU, announced his resignation the following day.

Theresa May, who replaced Cameron as leader of the Conservative party and prime minister, stepped down voluntarily on June 7, 2019 after facing severe pressure to resign. The new Brexit deadline is October 31, 2019. Brexit will result in the UK having more control over negotiating trade deals and agreements with the non-EU countries. But it may lose its negotiating power especially with large economies like India, China and USA. Across the globe, negotiations are moving towards Blocs such as EU, ASEAN, and NAFTA.



Industries that depend on migrant labour could be impacted after Brexit. The European Free Trade Association was formed in 1960. UK was a founding member. Brexit will lead to UK losing access to the single market. Until the actual exit of the UK from the EU, the UK must negotiate free trade agreements with the EU and other nations.

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Now after Brexit, the number of migrants looking for jobs outside the UK has increased. There is also a fear of economic recession looming large. Immigrants in UK make a significant contribution to the health care sector; so if they leave the UK, it will lead to a mismatch between demand and supply of skilled workers. As UK was part of the single market, it was able to attract many foreign investors due to the absence of tariff barriers. If UK decides to leave the EU, FDI inflows in UK may recede. SMEs (small and medium enterprises) will find it difficult to seek credit.

The net contribution of UK to the EU amounted to around £8.5 billion each year. Brexit can save the UK government from having to contribute every year. Further, UK can make business deals with countries across the world like China and Australia. It is expected that Brexit will reduce barriers to UK's banking and insurance sectors.

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11 FREE TRADE AGREEMENTS

LEARNING OUTCOMES

1. To examine what free trade agreements are
2. To review the different types of trade agreements
3. To understand the role played by WTO in trade agreements
4. To understand the merits and demerits of free trade agreements

INTRODUCTION

Free Trade Agreements (FTAs) are arrangements between two or more countries or trading blocs such that there is a mutual agreement to reduce or eliminate customs tariff and non tariff barriers on trade between them. Free trade agreements cover trade in goods (agricultural or industrial products) or trade in services (banking, construction etc). FTAs can also cover intellectual property rights, investment, government procurement etc.

Free trade agreements were beneficial to US exporters as foreign markets opened up for them. Barriers to trade were reduced. There was a stable and transparent trading environment. Trade agreements impact international trade.

There are three types of trade agreements

1. Unilateral trade agreement – This occurs when a country imposes trade restrictions and no other country reciprocates. These agreements can result in a country losing its competitive advantage. However, countries like US resort to such agreements to enable emerging markets to grow.
2. Bilateral trade agreements – These are agreements between two countries wherein they agree to relax trade restrictions to open up trade. Tariffs are lowered. For most countries, the agreements are in automotive, oil or food production industries.
3. Multilateral trade agreements – These agreements are among three countries or more. As the number of participants increases, the complexity of negotiations also increases. These agreements are considered powerful because they cover a large geographic area. Countries grant each other most favored nation status.

The North American Free Trade Agreement between US, Canada and Mexico is considered the largest multilateral agreement with a combined output that is $ 20 trillion.

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THE ROLE OF THE WTO IN TRADE AGREEMENTS

The World Trade Organisation (WTO) is an international body that negotiates global trade agreements. It also enforces agreements. WTO is the only global international organization dealing with the rules of trade between nations.

The WTO agreements are negotiated and signed by world's trading nations. WTO ensures that trade flows as smoothly and as freely as possible. It operates a global system of trade rules and settles trade disputes between its members. WTO also supports the needs of developing countries.

In the Doha round of negotiations, both the US and EU resisted lowering of farm subsidies. These subsidies made the food export prices lower than those in many emerging economies. This adversely impacted local farmers who were already suffering from the vagaries of monsoons. Thus, the Doha round of negotiations ended up in a failure. This improved the prospects for China as it signed bilateral trade agreements with countries in Africa, Asia and Latin America. These examples showcase the limited power that WTO has when it is a question of enforcing trade agreements.

ADVANTAGES OF FREE TRADE AGREEMENTS

1. Free trade agreements increase trade between countries.
2. There is an increase in economic growth.

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3. Business climate becomes competitive as local players are encouraged to take active part in global market.
4. As government subsidies to local industry are removed, those funds can be used for infrastructure development.
5. Growth in Foreign Direct Investment (FDI) leads to infusion of capital to boost domestic industry.
6. There is transfer of technology and know-how between global firms and domestic firms.

DISADVANTAGES OF FREE TRADE AGREEMENTS

1. Free trade agreements result in massive layoffs and job losses as jobs get outsourced. As companies have to operate in an intensely competitive market, they are forced to reduce costs and improve their operational efficiency. As a result of NAFTA, many US jobs shifted to Mexico.
2. Developing countries do not have a legal framework to protect patents and inventions. Corporations realize that their ideas are stolen by local players.
3. In emerging markets, domestic industry may not be able to compete with the multinationals and so they may be forced to reduce the scale of their operations leading to widespread unemployment which in turn increases the crime rate.
4. Smaller countries lose revenue from import tariffs.
5. Free trade agreements may lead to rampant abuse of natural resources in emerging economies.

Trade protectionism is not the solution to address the demerits of free trade agreements. Rather, regulations have to be enforced within trade agreements. To prevent destruction of natural resources and protect the interests of local communities, environmental safeguards have to be in place. Countries can insist that multinational companies build local factories and create avenues for employment.

INDIA: FREE TRADE AGREEMENTS, EUROPEAN UNION & ALPHONSO MANGOES

Ms Nirmala Sitharaman, commerce and industry minister issued a statement in 2014 saying that free trade agreements have not benefited India as much. This statement came amidst the euphoria generated in the last few years by the Congress government that India had a prominent role in WTO negotiations. Even PM Narendra Modi had slammed India's FTA with the EU saying that it would hamper the prospects of India's dairy sector. (Ms Sitharaman is presently the Finance Minister).

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The initial noises coming from the current government seemed to resonate well with the earlier stance of the BJP. As per the FTA with EU, India had agreed to import milk and milk products from EU. It was feared by the BJP that FTA with EU would compromise India's agricultural sovereignty and food security.



It is good on part of the Government to have decided to undertake a comprehensive review of India's bilateral trade pacts including FTAs. For some time now, the domestic industry in India has been clamoring against giving increased market access to developed countries without substantive benefits in return. It is high time that India stopped getting a raw deal from the developed economies in the name of globalization.

Of late, the Indo-EU trade relation has been going through a rough patch. EU banned India's Alphonso mangoes and other vegetables on the grounds that they contained harmful organisms. Recently EU has also proposed a pan on imports of betel leaves (the ubiquitous paan) from India into the UK saying that there is a threat of salmonella food poisoning from paan leaves. The ban on Alphonso mangoes has benefited the Indian consumers as the prices of mangoes have crashed as a fall-out of the ban imposed by EU.

Earlier EU had banned the import of poultry meat from India citing the spread of bird flu as a reason. These fears have now subsided and now the ban has been lifted after 5 years. India exports poultry products (eggs and processed meat) worth Rs.500 crore every year of which the exports to EU alone account for 20-25%.

India and the 28-nation EU block have been trying to negotiate since 2007, albeit unsuccessfully. EU wants the FDI cap in insurance to be hiked to 49% and it is unlikely that BJP government will agree to this. Even the proposal for FDI in multi-brand retail has been put on the back burner.

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EU has been demanding duty cuts in automobiles, tax reduction in wines and spirits and dairy products and a stronger intellectual property regime. India is asking for granting data secure nation status by EU as this will help Indian IT companies wanting market access. Controversies apart, there is a greater need today to make India more competitive in exports. Needless to add, this should not be at the expense of local players. Export growth has been stagnating and carefully orchestrated reforms are needed.

India exports merchandise worth $54 billion to the EU as against imports of $58 billion from European bloc. So, in that sense, our imports from EU are more than exports and this will have some impact on the current account deficit.

Experts point out that successful conclusion of BITA (Bilateral Trade & Investment Agreement) between India and EU is a must as investors from Europe are bullish about India's growth potential. Hard decisions are needed to spur growth and investment. Completion of the negotiations will benefit India's textile sector which has been facing tough competition from Bangladesh and Pakistan. EU is the largest importer of India's textiles.

Thus, the task before the present government is not easy considering a balance/ a trade-off is not a simple affair – especially in the international business domain. You can't cut your nose to spite your face. India should plan well for the negotiations with EU so that the outcome results in a win-win situation for both India and EU. We have to wait and watch as to how things will unfold in the near future.

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12 BARRIERS IN INTERNATIONAL TRADE

LEARNING OUTCOMES

- To understand the tariffs levied on international businesses
- To examine the non tariff barriers in international businesses

NON TARIFF BARRIERS

SUBSIDIES

- Monetary help by the government to the local firm so that their products are competitive.
- Use of public funds to make an industry competitive.
- Agricultural subsidies most common (US, Europe, France).

Indirect Subsidies – Examples - free power to farmers, seeds supplied at a lower rate through government controlled organization. Some governments try to help airlines because these industries are of a strategic importance.

(Impetus to airlines ⇨ More foreign travelers ⇨ Greater foreign exchange)

Export subsidies – China sells corn below world price and below the cost of domestic procurement. This is an export subsidy. These practices distort trade. China, Canada, Australia were creating export subsidies through pool pricing, cross subsidization of commodities or even long term supply agreements between governments.

Pool pricing– Price pooling is a mechanism where there is potential for balancing the customer and developer expectations with that of suppliers.

Cross subsidization is the practice of charging higher price to one group of consumers in order to subsidize lower price for another group. When a firm has related products it may chose to charge a price that is at or below cost for one product and sell the other at a price above cost.

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CONDITIONAL SUBSIDIES

These are subsidies that require recipients to meet certain export targets or subsidies that require recipient to use domestic goods.

CUSTOMS VALUATION

Customs officers must levy the duty on the declared invoice price; the customs officer may suspect that invoice prices are undervalued. The customs official may asses the real price based on price of identical goods. The arbitrary value of goods fixed by customs officials is a non tariff barrier. Some countries can play mischief by using higher valuation on certain imports.

Countervailing Duties: If subsidized imports are hurting domestic producers, then countries can charge extra duty this is countervailing duty.

Anti-dumping Duty: Charging extra import duty on the particular products from the particular exporting country to bring its price closer to domestic prices in the importing country. Developing countries are afraid that developed countries will dump the goods (at a price that is much lower), capture the overseas market, marginalize the original domestic players and then start milking the market.

Administered Minimum Price Levels: Importing country may set a minimum price for importing overseas product. This limits the competitive power of the overseas product in the importing country.

Customs deposits and special fees: Payments of deposits with the customs in advance of the shipment.

Tied aid: A developed country may give aid to developing country or to an LDC (Least Developed Country) → Condition that a designated proportion of the aid should be spend on purchase in the donor country.

If India got a loan from US at low interest rate, but a part of loan has to be spent on buying wheat from US, it does not serve the purpose of making India self-reliant in food. Tied Aid is not exactly a win-win situation because the donor country's productivity does not improve.

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NON TARIFF BARRIERS THAT CONTROL THE IMPORT QUANTITIES

Quotas– Restrictions on imports of goods to a particular level in a given year.

MFA (Multi Fibre Arrangement) – In 1974, developed countries wanted to protect their domestic textile sector from the growing competition from textiles produced by firm in developing countries.

After WTO agreement in 2005, quotas/MFAs will only be used if a country needs it as per its balance of payment position.

Balance of Payment – A record of all transactions made between one country and all other countries during a specified period of time.

Export Quotas – protect natural resources; influence the world pricing of that commodity/ product. Quotas linked with export performance that is a firm can import required inputs in proportion to its export of products.

The other Non-Tariff Barriers are;

a. Technical barriers to trade
b. Environmental standards
c. Labour standards
d. Bureaucratic delays

TECHNICAL BARRIERS TO TRADE

A country may specify a technical regulations and standards that mention specific characteristics of product like size, shape design, functions, performance or the way a product is labelled or packaged. If a "Gucci" brand is made in Vietnam, the product label must mention that it is 'Made in Vietnam'. Technical procedures are also included which confirms that the products meet technical standards as laid down. But if these rules are used to discriminate between countries and to protect domestic industries from foreign competition, then these go against the basic objective of 'free trade'. Technical standards then become technical barriers to trade.

ENVIRONMENTAL STANDARDS

International agreements

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Montreal protocol – protection of ozone layer

Basel convention– Trade or transportation of hazardous waste across international borders – but when environmental issues are misused, then to protect domestic industry, then such measures classify under Non-Tariff Barriers.

Labour standards (Controversial subject)

Carpets from Iran banned/restricted because the carpet industry in Iran used child labour to a considerable extent.

- Should a country's export be restricted because it uses child labour or forced labour.
- Does the country have a right to restrict such trade?
- Can a country impose its value system on another country?
- If a country has less labour rights does it gain any unfair advantage?

Many developing countries that developed countries use labour standards to encourage domestic protectionism.

BUREAUCRATIC DELAY TACTICS

A Srilankan minister once said that 'So many questions are asked at Indian customs' that the exporters are fed up. Excessive demands for documentation are other Non-Tariff Barriers. Srilanka alleged that India gave it permission to land goods only at a few designated ports and this was perceived by Srilanka as a Non-Tariff Barrier.

EU-NTBs are characterized by delayed or extended administrative and inspection procedures; delayed lab test reports. These delays signify loss of opportunity for exporter.

Example: French decided that imports of Japanese VCRs were excessive; they applied the rules and gave VCR a complete inspection. The number of VCRs entering the country dropped from thousands to six per day.

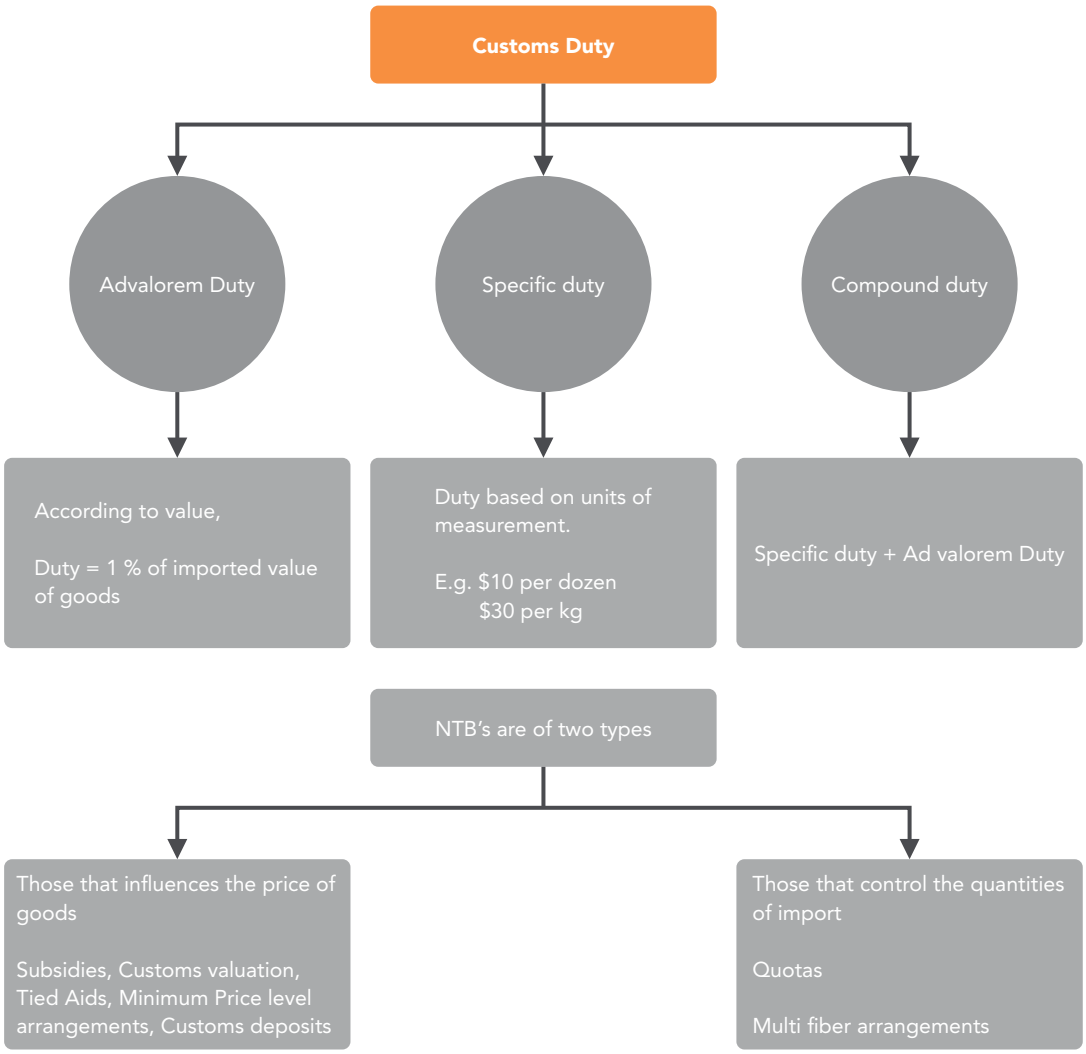
Imports in a country are controlled by

1. Tariffs levied.
2. Non-tariff action

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Tariff= (Duty) is a tax levied by the government on an imported good as it enters the country. Tariff is levied on imported goods to protect the domestic industry .It also adds to the government revenue.

Due to the increasing influence of GATT, tariffs are no longer barriers to international trade. To restrict Exports, government may levy export duty. This is to support the domestic industry. Tariffs measures are on the Wane due to the increasing power of WTO. The other idea is that when government increases the export duty this would encourage foreign direct investment. Non tariff barriers are levied due to the political and protective measures of a nation.



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13 FOREIGN DIRECT INVESTMENT (FDI)

LEARNING OUTCOMES

- To understand the reasons for growth in FDI across the globe.
- To evaluate the significance of FDI for developing countries.
- To learn about transnational corporations and their strategies.

INTRODUCTION

FDI is a form of investment that gives the investor a controlling interest in a foreign company. To promote FDI, countries like Vietnam have replaced obstacles with incentives. Both developing and industrialized countries have deregulated markets, privatized national enterprises, liberalized private ownership and encouraged regional integration in an effort to create more favorable climates for foreign investment.

Foreign Direct Investment is a major contributor to global growth and development, spreading the benefits of capital, technology, management expertise, jobs and wealth to every corner of the world.

In both home and host countries, governmental policies can either foster or restrict the FDI policies of multinational enterprises. In both countries, for example, a variety of groups work to regulate the impact of giant companies, which can exercise considerable power in negotiating the terms of FDI allocation.

The government policies can either encourage or restrict FDI. Every country can use the money that comes with FDI, but many worry that the global orientation of the multinational enterprise (MNE) may render it insensitive to local interests and concerns.

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HOW IS FDI IMPORTANT FOR DEVELOPING COUNTRIES?

1. Foreign investment is seen as filling the gap between the domestically available supplies of savings, foreign exchange, government revenue and human capital skills and the desired level of these resources necessary to achieve growth and development targets. Export earnings fall short of target. This is called as deficit or gap.
2. An industrial enterprise established by a foreign company gives birth to several other enterprises which supply inputs to parent company. Every dollar of FDI increases domestic investment by 80% of the amount of FDI.
3. FDI can generate healthy competition in host countries. When FDI is in the form of setting up green field ventures, the result is creation of new enterprises, adding to the number of players in the market.
4. Location specific advantages attract FDI. Examples – availability of natural resources like oil, minerals, which are by nature specific to certain countries. So, many businesses are keen to invest in countries with rich natural resources via the FDI route. Example: Hyundai, the automobile giant from South Korea, chose Chennai for its car manufacturing plant. Skilled labour at low wages, location of auto part manufacturers like Wheels India, Brakes India, Sundaram Brakes, Bimetal Bearing and India Pistons in and around Chennai, guaranteed power supply, cheap land, proximity to sea port have attracted Hyundai to Chennai.

FDI helps growth of GDP in developing countries. FDI acts as a significant source of tax revenues for the host country. Consumers get a wide variety of choice of products. Domestic industries get benefit of advanced technology. FDI generates employment opportunities in developing countries, which increases disposable incomes of population and therefore spending power, which in turn triggers growth in other sectors. Example – people may want to buy an asset, land, home, car, two-wheeler or people can take bank loans as they have the repayment capability. This makes the banking sector vibrant. Services get a boost. Thus, FDI successfully triggers chain reaction in host countries and improves their economic prospects.

TRANSNATIONAL CORPORATIONS (TNCS) AND FOREIGN DIRECT INVESTMENT (FDI) DECISIONS

The context for transnational corporations has changed due to technological changes, modern methods of production and greater transparency of business operations. New opportunities are emerging for transnational corporations. As markets open up, transnational corporations get access to new geographies. Firms can use a variety of methods like FDI, trade, licensing,

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subcontracting, franchising etc. so that they can do business in different locations. Even SMEs can become transnational corporations due to advances in information, communication and transportation technologies and innovative managerial techniques.

These developments exert businesses to leverage new opportunities otherwise they run the risk of losing the market to competition. The ability of firms to use resources effectively determines their competitiveness.



Many transnational corporations continue to grow and their turnovers are larger than national incomes of many developing countries. A few telecom operators from developed countries have utilized the opportunities to become transnational corporations. Smaller firms from developed countries seek to explore these opportunities and look for strategic alliances. The number of transnational corporations has increased substantially in the last few years.

Transnational corporations have become important actors in the world economy. The decision where to locate the production facilities has become significant.

REASONS FOR THE INCREASED FOREIGN DIRECT INVESTMENTS

Availability of capital and labour, new technologies and skills have contributed to the growth in Foreign Direct Investment. This growth is also dependent on how each nation responds to changing economic conditions. Massive advances in transportation and communication technologies have also fuelled the growth of FDI. Rapid introduction of new products, shorter product cycles and agility of supply chains are becoming differentiators. Thus, cost has ceased to remain the differentiator among competitors in the market. Today there is more pressure on countries to innovate in the policy arena. Trade barriers are being removed and internal markets are getting deregulated. In addition, privatization and liberalization of technology and investment flows at the national level is adding to the momentum.

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BENEFITS OF FDI

- Fill the gap in resources necessary to achieve growth and development targets
- FDI can reduce deficit on the balance of payments current account
- Multinational enterprises can generate export earnings
- The host country can earn tax revenues; the taxes can be mobilized as a source of public financial resources for development projects.
- MNCs share technology, technical know-how and managerial experience.
- FDI can support poverty alleviation programs in emerging economies
- Consumers have access to a wide choice of products and services
- Growth in GDP is achieved.
- As competition intensifies, price wars result which eventually benefit the consumers.

But there are drawbacks as well. When MNCs buy out popular local brands/ companies, no benefits result. When Thums Up was acquired by Coca Cola, it was merely a ploy to kill the competition. Hindustan Unilever's takeover of TOMCO (Tata Oil Mills Company) and Lakme only benefited Unilever.

PROBLEMS OF FDI

1. Cultural and moral degradation
2. Intense lobbying by MNCs
3. Bribery and Corruption
4. Exit of small and marginal firms
5. It can interfere with politics of the host country

WHAT IS TECHNOLOGY TRANSFER? HOW DO HOME COUNTRY AND HOST COUNTRY REACT TO TECHNOLOGY TRANSFERS?

Technology transfer is a process that permits the flow of technology from a source to a receiver. Source is the owner or holder of the knowledge and it can be an individual, a company or a country and the receiver is the beneficiary of the transferred technology.

Technology transferred through published material (books/ journals), purchase and sale of machinery, equipment and intermediate goods, transfer of data and personnel and interpersonal communication.

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HOME COUNTRY'S REACTIONS

- Express concerns about export of technology to foreign shores.
- Establishment of production facilities by MNCs in subsidiaries abroad decrease export potential of home country.
- MNCs import from their subsidiaries, so imports of home country also increase.
- Due to decrease in exports and increase in imports, balance of trade becomes adverse.
- Technology transfer impacts the competitive advantage of home country adversely.
- Labour unions in home country also oppose technology transfer as they fear that the jobs generated from new technology will benefit only host country citizens.

HOST COUNTRY'S REACTIONS TO TECHNOLOGY TRANSFERS

Reactions of host country are severe too. The economic implications include payment of fee, royalty, dividends, interest and salaries to foreign technicians and tax concessions resulting in loss to national exchequer. As payments have to be transferred to home country, drain in forex results. The technology supplier extracts payments through other ways like over pricing and buying intermediates from sister concerns at high prices. There are mal practices also like tied purchases, restriction on exports.

It has been found that the technology being imported to a developing country is not needed or inappropriate. Technology developed by MNCs is more suitable for industrialized countries where capital is in abundance. These technologies are useful for production of high quality sophisticated goods on a large scale and using higher level of professional skills in place of sheer labour and replacing natural resources by synthetics. These technologies do not serve the labour intensive economies of developing nations.

Social and cultural implications of technology transfer are severe too. Cultural degradation is a reality now. Majority of neo rich Indians are influenced by Western culture and are Americanized in their attitudes, behaviors, food habits and dressing sense. We invariably end up importing technology from US & Europe. Influence of alien culture on Indian soil is increasing. Social problems like pollution, urbanization, traffic congestion, depletion of natural resources. Coke has been accused of plundering India's ground water. Syngenta/ Monsanto are MNCs who are manufacturing pesticides / harmful chemicals in India.

Host countries should act to minimize the adverse effects. If we oppose Technology transfer, it will be similar to throwing the baby along with the bath tub.

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HOW CAN THINGS BE IMPROVED?

1. Identify and set entry conditions for foreign investors.
2. Reserve certain sectors for local producers
3. Try and eliminate restriction on use of technology by MNCs
4. Limit royalty payments to foreign firms.
5. Use cost benefit analysis to improve negotiating abilities
6. Encourage MNCs to sell technology on a contractual basis.
7. Let MNCs train host country professionals.
8. Give more incentives to MNEs for setting up R&D facilities in host countries
9. Develop clusters of related activities and promote interaction with universities, co-operatives, research associations and private firms.
10. Encourage greater technology diffusion within the home country.

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14 THEORIES OF FDI

LEARNING OUTCOMES

- To understand the various theories pertaining to Foreign Direct Investment
- To examine the relevance of these theories

INTRODUCTION

We propose to discuss five theories which provide theoretical rationale for FDI to occur. The theories are:

1. Product life cycle
2. Market imperfections
3. Eclectic
4. Market Power and
5. Internalization

PRODUCT LIFE CYCLE

Product life cycle theory explains the flow of trade among countries. Since the theory has investment implications, it is being investigated here. The theory states that a company will begin by exporting its product and later undertake FDI as the product moves through its life cycle. The theory indentifies three stages in the life cycle of a product: new product, maturing of the product and standardization of the product.

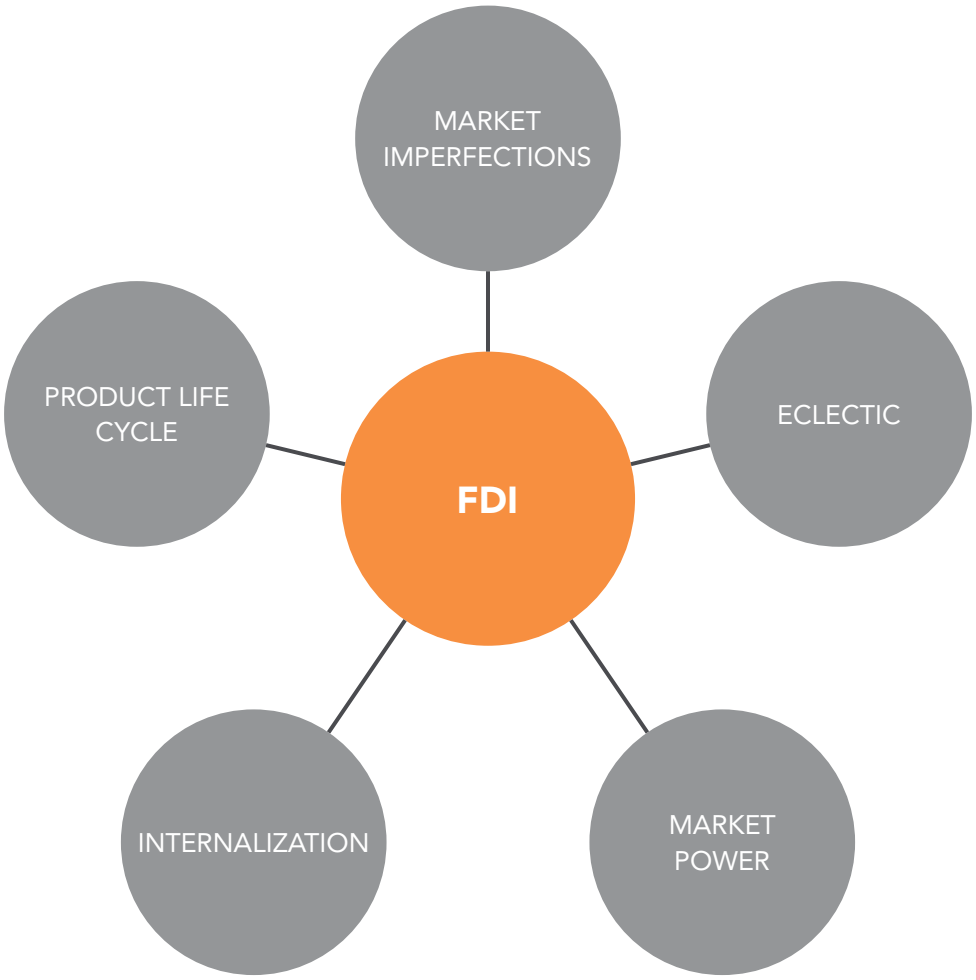
At the new product stage, a product is produced in the home country only, as its fortunes are not yet known. The production process is kept close to the research department that has developed the product. In the maturing product stage, the firm directly invests in production facilities in countries where demand is high thus necessitating own production facilities. In the final standardized product stage, increased competition creates pressure to reduce production costs. In response, the company builds production capacity in low cost developing nations to serve its markets around the world.

The product life cycle theory has merits as well as demerits. The theory makes economic sense. No company will invest in another country if they know that the market is saturated

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and demand is stagnant. Developing countries often accuse MNCs of transferring outdated technology. Toyota, for example, introduced Qualis in India, a vehicle that was almost junked in other countries. But, from the product life cycle perspective, such late transfer of technologies is a natural phenomenon. Any innovative company would like to wait and watch before venturing to invest in other countries.

The product life cycle theory fails to explain why some MNCs do not believe in gradual expansion of production facilities. In the computer industry, where dislocation of technology occurs fast, a company seeks to enter the world market simultaneously, recover costs and make profits, before its product enters its final stage of maturity followed by abandonment.



The theory is also silent on the reason why companies choose FDI over other forms of market entry. Licensing route can be used to access special assets needed to manufacture a particular product. This route helps avoid the risk associated with FDI. Finally, the theory fails to explain why firms choose FDI over exporting activities. It might be less expensive to serve a market abroad by increasing output at the home country factor rather than by building additional capacity in the target market.

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THEORY OF MARKET IMPERFECTIONS

The theory of market imperfections, also called internalization theory, focuses on imperfections in the market (for example: trade barrier would decide FDI. If trade barriers render a transaction less efficient than it could be, a company will undertake FDI to internalize the transaction and thereby remove the imperfections). In other words, a firm chooses to invest in overseas facilities if a transaction with a foreign firm (through franchising, licensing or supply agreement) proves to be more costly. Market imperfections can lead to escalation in costs due to prolonged negotiations. When transactions are low, MNCs are likely to contract with outsiders through licensing or franchising instead of investing in the foreign country through the FDI route. For example – Starbucks has always preferred the franchising route in international business as this reduces the transaction costs.

ECLECTIC THEORY

Advocated by John Dunning, the eclectic theory argues that a location in question attracts FDI because it combines the unique advantages of ownership, location and internalization. According to Dunning, FDI will occur when these three conditions are uniquely combined.

1. OWNERSHIP ADVANTAGE:
   This advantage stems from the fact that the firm is proprietary to some unique competitive advantage that enables it to overcome the disadvantages of competing with foreign firms in overseas markets. The unique advantage may be brand recognition, technical knowledge, economies of scale or management ability. It may also be the result of improved production methods or ability to turn loss-making firms into profitable ones. For example – Lakshmi Mittal, the steel tycoon, was known for his ability to turn around loss making firms.
2. LOCATION ADVANTAGE:
   This refers to the advantage of locating a particular factory in a specific location because of the unique characteristics of that location. These advantages have historically been natural resources such as oil in the Middle East, timber in Canada and Copper in Chile. Cater Pillar, for example, manufactures bulldozers in Brazil to take advantage of lower labour costs and avoid high tariff rates on goods exported from its U.S factories. In India, Pune and Chennai are locations that have proved to be ideal locations for automotive industries.
3. INTERNALIZATION ADVANTAGE:
   This arises from internalizing a business activity rather the than leaving it to a relatively inefficient market. The firm must benefit from controller (internalizing) the foreign business activity than leaving it to a local company to provide the service Control

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is advantageous when monitoring and enforcing the contractual performance of the local company. It is expensive where the local firm may misappropriate proprietary technology, or when the firm's reputation and brand name could be jeopardized by the poor behavior of the local company.

TABLE OF THE ECLECTIC THEORY OF FDI

	OWNERSHIP ADVANTAGE	LOCATION ADVANTAGE	INTERNALIZATION
EXPORTING	X	--	X
LICENSING, FRANCHIZING etc.	X	X	--
WHOLLY OWNED (FDI)	X	X	X

MARKET POWER

The market power theory states that a firm seeks to establish a dominant market presence in an industry by undertaking FDI. Dominant market presence results in greater profits to the firm. Market power is often sought to be achieved through vertical integration. Such integration may be the extension of the company's activities into its supply chain (backward integration) or the absorbing of its output (forward integration).

Forward integration involves gaining ownership or increasing control over distributors or retailers. Increasing numbers of manufacturers today are pursuing a forward integration strategy by establishing websites to sell products directly to consumers. An effective means of implementing forward integration is franchising. Business can spread rapidly by franchising because costs and opportunities are spread across many individuals.

Background integration is a strategy of seeking ownership or increased control of a firm's supplies. This strategy can be especially appropriate when a firm's current supplies are unreliable, too costly or cannot meet the firm's needs.

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INTERNALIZATION APPROACH

Propounded by Buckley and Casson, the internalization theory is based on two principles

1. Firms internalize missing or imperfect external markets until the costs of further internalization outweigh the benefits
2. Firms choose locations for their constituent activities that minimize the overall costs of their operations. Expansion by internalization of markets means that firms use FDI to replace imperfect external markets in intermediate products and appropriate the profits from doing so.

The internalization theory of multinational firms proposes that direct international investment is a result of a firm having information-related intangible assets.

FACTORS INFLUENCING FDI

Several factors influence the decision relating to the flow of FDI. These can be classified into three categories: Supply, demand and government.

Supply factors	Demand factors	Government factors
Production costs	Customer access	Economic priorities
Logistics	Follow clients	Avoidance of trade
Resource availability	Follow rivals	Barriers
Access to technology	Exploitation of competitive advantage	Economic development incentives

SUPPLY FACTORS

Supply factors include production costs, logistics, resource availability and access to technology. These factors influence a firm's decision relating to FDI.

PRODUCTION COSTS

Firms seek competitive advantage through low production costs. MNCs locate production facilities in low wage countries. Ford has set up a company at Chennai (India) to make

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one lakh vehicle per annum. Ford plans to export cars to South Africa from Chennai. Over the last two decades, more than 2000 maquiladoras have sprung up near the vs Mexico border. These plants take advantage of low wages to assemble American made components for re- export.

Local incentives were the main motive behind Intel establishing manufacturing operations in Costa Rica, and Mercedes locating a manufacturing plant in Alabama.

LOGISTICS

MNCs seek to invest in subsidiaries in foreign markets if the cost of shipping raw material is high. Coke and Pepsi have set up bottling plants in India as the cost of transporting water from the country is considerable. Also, international business often makes investments in host countries to reduce distribution costs. The liberalization of Latin American markets bought a surge of foreign direct investment in transportation and physical distribution, and foreign logistics providers have upgraded the region's transportation and warehousing facilities.

NATURAL RESOURCES

MNCs tend to utilize FDI to access natural resources that are critical to them. Natural resources attracts many MNCs. Japan, for example, is a small densely populated island nation with very few natural resources of its own, especially forests.

But Japan's largest paper mill, Nippon Scishi, does more than simply import wood pulp. The company owns huge forests and corresponding processing facilities in Australia, Canada and the US. This enables Nippon Scishi to have access to an essential resource like wood pulp. Likewise, to access cheap energy resources used in manufacturing, several Japanese firms are relocating production to China, Mexico and Vietnam, where energy costs are lower. US oil companies are a classic example. Because of the decrease in oil production in the US, many oil companies have been forced to make significant investment worldwide to obtain new oil reserves.

KEY TECHNOLOGY

Technology and business have been intertwined since the industrial revolution. The connection between the two became even stronger in the information age, particularly with the advent

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of electronic business exchanges. Technology influences every aspect of the global market place driving innovation, affecting partnerships and location and changing the relationships between a business and its stakeholders.

One of the motives behind FDI is to gain access to technology. Many of the Swiss pharmaceutical companies have invested in small biogenetics companies in USA in order to gain cutting edge technology.

DEMAND FACTORS

Market expansion is another motive behind FDI. Included under this motive are such factors as customer access, following clients, following rivals, exploitation of competitive advantage and customer mobility.

CUSTOMER ACCESS

Certain international businesses need to be physically present in foreign markets to serve customers better. Starbucks, for example, cannot serve fresh coffee to its customers in Japan from its head office in the US nor can KFC provide freshly fried chicken to customers in India from its restaurants in the US.

Some countries have a strong "quality" reputation in certain product categories. German automotive engineering, Italian shoes, French perfumes and Swiss watches are known for their excellence in quality.

Because of these buyer perceptions, it can be profitable for a firm to produce its product in the country with quality reputation, even if the company is based in another country. For example, a perfume producer might want to bottle its fragrance in France and give it a French name.

COMPETITIVE ADVANTAGE

A company enjoying great reputation may seek to establish subsidiaries in overseas countries to encash on its popularity. An owner of a valuable trade mark, brand name or technology may choose to operate in foreign countries rather than export to them. Toyota's presence in India is a case in context; though it entered the Indian market late, Toyota has been able to leverage its worldwide reputation and position itself well among Indian buyers.

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FOLLOW THE CLIENTS

Often, clients of a company attract FDI. If one of the clients builds a foreign facility, the company may decide to locate a new factory of its own nearby, thus enabling it to continue to supply its customer promptly and attentively. The practice of 'following clients' is likely to be followed in industries in which main components parts are obtained from supplies with whom the company has a close working relationship.

For example: When Japanese auto makers set up their plants in the US, several Japanese component parts supplier also joined the bandwagon by establishing their own factories, warehouses and research facilities there. Similarly, after Samsung decided to construct and operate an electronic factory in north-east England, six of its Korean parts suppliers also moved into England.

FOLLOW THE RIVALS

Competitor analysis indicates the geographic strengths and weakness of individual rivals. From such analysis, firms can select markets for investment. MNCs routinely monitor market sizes and growth rates in over 150 countries. Obviously large and medium sized – growth markets are always attractive propositions, and firms compete to build factors in these regions (Asia or Latin America) and in countries such as India, Brazil and China. Similarly, large stable markets, such as North.

POLITICAL FACTORS

Political factors are often determinants of quantum and direction of FDI. Economic priorities of the host country, avoidance of trade barriers and development incentives are the major political factors impacting FDI.

ECONOMIC PRIORITIES

Economic priorities of developing countries often clash with profit motives of MNCs seeking to invest in such markets. In other words, developing countries want MNCs to invest in infrastructure development but the international business seeks to invest in consumer goods industries. Obviously, developing countries impose restrictions on the flow of FDI into their economies.

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India followed a restrictive policy towards FDI until 1991, relying more on bilateral and multilateral agreements. Inward flow of FDI was perceived essentially as a means of acquiring technology that was not available through licensing agreements and imports of capital goods. FDI was allowed in designated industries, subject to varying conditions on setting up joint- ventures with local partners, local content clauses and export obligations. Today India has allowed 100% FDI in the insurance sector.

The foreign exchange regulation Act, 1974 stipulated that foreign firms need to have equity holding only up to 40 percent. Exemptions were at the government's discretion. Foreign subsidiaries were induced to gradually dilute their equity holdings to less than 40 percent in the domestic capital market.

AVOIDANCE OF TRADE BARRIERS

Fuji photo Film Company has invested $200 million to set up a manufacturing plant in the US. Earlier, the company supplied film to its US customers from its factories in the Netherland and Japan. While exporting to the US, Fuji was paying 3.7 percent tariff imposed by the US government. This tax has been saved by producing the film in the US itself.

DEVELOPMENT INCENTIVES

Many governments offer attractive incentives and many throw a red carpet welcome to MNCs to invest in their economies. The theories of FDI explained earlier, give the reasons why developing countries invite FDI. The primary motive to attract FDI is to fill the resource gaps which exist in these countries.

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15 MULTINATIONAL CORPORATIONS

LEARNING OUTCOMES

- To understand the business operations of Multinational Corporations
- To review the characteristics of an ideal MNC
- To examine the merits and demerits of a MNC's operation to host countries

INTRODUCTION

A MNC is a company that does business in more than one country. Transnational company produces, markets, invests and operates across the world. It is an integrated global enterprise that links global resources with global markets at profit. These companies have sales offices / manufacturing locations in many countries.

- MNCs consider opportunities globally
- MNCs invest their assets globally
- MNCs engage in international production
- Operations in number of countries
- Managerial decisions based on global perspective.
- MNCs produce the products in one or few countries and sell them in most countries. Transnational corporations produce the products in each country based on specific needs of customers of that country and market these. A transnational corporation mostly uses the inputs of the host country where it operates unlike a MNC.

ILO DEFINITION

Home country: Managerial headquarters in this country

Host country: where the enterprise carries out the operations

A corporation that controls production facilities in more than one country, such facilities acquired through the process of FDI. Firms that take part in IB only by exporting or sourcing new technology cannot be called as Multi National companies.

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Global Corporation – produces in home country/ single country but markets products globally. Some operations are centralized, some are decentralized. International Corporation conducts operations in one or more foreign countries, but with a domestic orientation. They believe that domestic policies are better than foreign policies so extend the domestic factors for doing business globally in other foreign countries. MNC operates in more than one country, but operates like a domestic company of the country concerned. TNC produces, markets, invests and operates across the world.

ORGANIZATIONAL FEATURES	MNC	TNC
Assets and capabilities	Decentralized and nationally self sufficient	Dispersed, interdependent, specialized
Role of overseas operations	Sense and exploit local opportunities	Differentiated contributions by national units to integrated worldwide operations.
Development and diffusion of knowledge	Knowledge developed and retained within each unit	Knowledge developed jointly and shared world wide

WHY DO COMPANIES BECOME MNCS?

- Protection from uncertainties of business cycles, political policies of the domestic country
- Tap global markets
- Grow business
- Increase profits
- Reduce costs
- Overcome tariffs – In some countries, the companies need not pay tariffs, if they manufacture in that country and export those goods. So, such companies set up manufacturing facilities in those countries. E.g. NAFTA countries like USA, Canada, Mexico (NAFTA – North American Free Trade Agreement).
- For technological advantage – instead of licensing, companies produce goods directly.

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ADVANTAGES AND DISADVANTAGES OF MNCS TO HOST COUNTRY

Advantages – Contributes to economic and industrial growth, employment generation, access to latest technology, more business for domestic suppliers, more competition for domestic business, reduction of imports, favorable effect on balance of payments, domestic consumers get plethora of products and services. MNCs who export also earn foreign exchange. Good utilization of natural resources.

Drawbacks – Unsuitability of technology to host country, MNCs may not operate within the boundaries of national sovereignty, they may indulge in monopolistic practices, indiscriminate use of natural resources, focus only on consumer goods but not capital goods or development of infrastructure in host country, pollution, dumping of material, use of outdated technology to host country.

In Plachimada – in Kerala's Palakkad district in India, a village is in a legal dispute with American soft drink giant Coca cola due to groundwater depletion. The villagers said, "We want drinking water. No Coke, No Pepsi". Hindustan Unilever was accused of groundwater contamination with Mercury in Kodaikanal, a hill station in Tamil Nadu.

ADVANTAGES AND DISADVANTAGES OF MNCS TO HOME COUNTRY

Advantages: Create demand for home country products, create employment for home country people, earn forex for home country, produce products required by home country consumers by producing in foreign countries with foreign resources, save domestic country from environmental pollution, generates profits for home country by earning profits through business operations in host countries.

Drawbacks

- Transfer capital to other countries, unfavorable balance of payments
- Less employment opportunities in home
- May neglect industrial development in home country as transnational companies follow secular approach

WHY DO FIRMS DO BUSINESS ACROSS DOMESTIC SHORES?

- Increase Profits
- Seek larger markets

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- Achieve economies of scale through larger operations
    - Seek economies of global supply chain
    - Spread the business risk over different locations
    - See new technology and knowledge

CHARACTERISTICS OF AN IDEAL MNC

- Lose its parent identity and blend in where it operates
- Citizen of the world (absence of a polycentric approach)
- Takes up CSR (Corporate Social Responsibility) efforts
- Meet customer requirements across the world
- Seek efficiencies
- Seek new technology and new knowledge
- Act within the framework of local law, rules and regulations

The ideal MNC transcends the national boundaries and detaches itself from narrow national considerations. Therefore some people refer to MNCs as transnational corporations. A transnational corporation is globally integrated i.e. its considerations are for the entire worldwide operations as a whole; but at the same time, it respects the local (national) requirements.

Multinational companies with total control from home country or companies with decentralized operations in different countries move towards becoming a transnational corporation. Global companies with a firm base in the home country and tight control over foreign operations also move towards becoming a transnational corporation.

Developing countries should note that the size of a country's domestic market may not be a limiting factor in the establishment of successful MNCs abroad. Small countries like Switzerland and Finland have spawned MNCs like Nestle, ABB and Wartsila. The growth of businesses need not follow a linear path. Companies can take the international route and scale up their business.

Off shoring is shifting an activity abroad. R&D can be outsourced but there is a risk of losing protection offered by intellectual property rights. Back office processes, technical support functions like data entry, data processing, secretarial services, telemarketing, legal transcription and business process outsourcing are services that are generally subject to off shoring.

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Data processing, database services, software implementation, financial services, animation services and health services are also subject to off shoring. Medical transcription, diagnostics, testing and medical advisory services can be outsourced outside domestic country. An Indian radiologist in Chennai can interpret the X- ray report of a patient who is based in US. Due to the popularity of Ayurveda and Yoga across the world, the prospects of medical tourism are bright in India. Even engineering services like engineering design and architectural services are being off shored. Countries like India and China can be players where engineering services can be off shored.

North-North activity

In international business, North means developed nations. South means all other nations.

EXAMPLES OF OVERSEAS ACQUISITIONS

1. Tata Motors – assembly operations in Malaysia, Russia, Ukraine, South Africa, Kenya and Bangladesh. It sells Tata Indica in UK through a marketing alliance with Rover.
2. Tata Motors acquired Daewoo Commercial Vehicles in Korea.
3. Reliance purchased German polyester manufacturer Trevira for US $ 95 million in June 2004. Trevira has a capacity of 130000 tonnes per annum of polyester fibre and yarn spread across units in Germany, Denmark and Belgium. With this acquisition, Reliance has become the world's largest producer of polyester in terms of its capacity.
4. Infosys has 26 global software development centers in US, Canada, UK, Australia and Japan
5. 80% of the turnover of Tata Consultancy Services is from overseas.
6. Ranbaxy sold in more than 100 countries and had manufacturing operations in seven countries.
7. Dr Reddy's labs have operations in several countries.
8. Asian Paints, an Indian manufacturer has manufacturing facilities spread over 24 countries.
9. 30% of the turnover of Aditya Birla Group is from overseas business.
10. Essel Propack is the world's largest maker of tubes used to pack tooth paste. The firm has 17 plants in 11 countries including China.
11. Sundaram Fasteners acquired a plant in Chennai.
12. Indian companies are getting listed in the New York stock exchange and also on NASDAQ.
13. India is exporting cars, two-wheelers and auto components.

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In 2004, a business magazine in India called as "Business World" developed the Global 100 rankings. It measured the Indian firms on two metrics:

1. Globalness i.e. Share of total revenues coming from international markets.
2. Global competitiveness which takes into account the revenues, profitability to support global expansion and the pace at which the company is growing.

Only a handful of Indian companies have both Globalness and global competitiveness. Many Indian companies scored high on global competitiveness but low on Globalness. This is because though they had financial capabilities, these companies had not ventured abroad.

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16 CULTURAL INFLUENCES IN INTERNATIONAL BUSINESS

LEARNING OUTCOME

- To understand the importance of culture in the success of international business operations

Culture is the collective programming of the mind that distinguishes the members of one group or category of people from one another. Culture can be learnt. It is essential that businesses wishing to expand their global footprint understand the cultural signals. Risk assessment must involve evaluation of costs and determining business viability. Foreign companies can factor delayed decision making into their costs. The sales and marketing strategies have to be designed by keeping the cultural factors in sharp focus.

CASE 1: INDIAN MANUFACTURERS

- An Indian management consultant had gone to Brussels, capital of the European Union. He saw that the Western part of Europe used bicycles. Many bicycles had the "Made in China" tag but none of the cycles seemed to be having the "Made in India" tag. He spoke to the head of the Indian delegation at an organization to promote the Indian goods in that part of the world. Why were Indian bicycles not sold? The reply was crisp. "Indian bicycles are heavy, whereas, the Europeans prefer lighter ones. Lighter bicycles are not made in India".
- Indian manufacturers were unaware of the culture in Europe. Europeans never rode their bicycles double seat. Europeans used the bicycle as a short distance private convenience vehicle – signifying freedom. In India, the economic and cultural patterns are different. So, to design the appropriate product, one has to understand the culture.
- Indian manufacturers were not interested in walking the extra mile to manufacture bicycles that were light and affordable. They were happy with little successes whereas Chinese manufacturers were more ambitious.

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CASE 2: P&G IN JAPAN

- P&G wanted to sell disposable diapers in Japan. Japanese are savings oriented and thrifty. They do their laundry every day and the disposable diapers are used only at night. A local company introduced a disposable diaper with reusable parts resulting in a drop in the sales of diapers sold by P&G. Matters improved only when P&G introduced a different economically priced diaper to suit the thrift conscious Japanese population.
- McDonalds and KFC started providing vegetable burgers along with non vegetarian items to take care of the needs of Indian customers.
- Business is a two-way communication and it cannot be run by a method of trial and error. The risk of failure by using a trial and error method is more in an intercultural business. In international business, a conscious effort is made to study and understand the various cultures.

INDIVIDUALISM AND COLLECTIVISM

- Individualism refers to the prominence that is given to an individual's goals. The person looks after himself and his immediate family. Collectivism emphasizes the group's goals. The person belongs to an in-group. In-groups are groups that are important to their members and groups for which individuals will make sacrifices.

COLLECTIVISTIC CULTURE AND JAPAN

Japanese management practices like Keiretsu, Total Productive Maintenance, Quality Circles, JIT Production System, Lean manufacturing, the global supply chains – these have their origin in the collectivistic culture of Japan where one's company and the lead-company are the primary in-groups. A Japanese man places his company before himself.

In international business, companies cannot afford to have a nebulous approach. Nation is another in-group that binds the Japanese together so that the national government can take hard decisions that have their effect on the industries.

A Professor from the US visited a large conglomeration of private engineering, medical and management colleges in India. He was astonished that a 25 year old youth was in charge of several important tasks like getting government approvals, grants, managing finances, setting up laboratories and technological up gradation in the classrooms. His official designation

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was Assistant Registrar. The young man turned out to be the nephew of the vice chairman of the group of colleges. No one in the organization and also outside of it thought that it was a wrong choice. Who could be more trustworthy than the nephew?

A study of the dominant in-groups in a country/ culture where one wants to do business is of immense utility in chalking out the international business strategy. Mr Morita, chairman of Sony, conceived the walkman. He liked classical music and wanted to listen to the music on his way to work without disturbing the fellow commuters. A Westerner may say that he wanted to listen to the music on walkman without being disturbed by other people.

In business negotiations, Americans would like to come straight to the point. The Arabs will consider it as a rude gesture if you come to the point straightaway. There is a strong allegiance to the religious group in Arab culture and therefore Arabs add "Insha Allah" (God willing) when they converse. The Arabs were actually nomads who were earlier fighting the hostile natural elements. Therefore, they appreciate friendships, long term relations and a continuing relationship with nature and the forces over which they have little control.

Horizontal collectivistic culture is one where people do not standout from others. Example – Japan

Vertical collectivistic culture is prevalent in Korea where the member of the in-group has the freedom to stand out. The American culture is vertical and individualistic. The culture in Sweden and Norway places a high value on equality as freedom. This culture is termed as individualist horizontal. These cultural differences have to be understood from the HR point of view.

High power distance cultures have more class and hierarchical distinctions. India has a high power distance culture. People accept that the superiors will consider their subordinates as not equal to them and coercive power used by the superior is acceptable to them. Business transactions in high power distance cultures are different from those in low power distance cultures.

In masculine societies, employees live in order to work. In feminine cultures, employees work in order to live. In such a culture, there is greater participation of women in the workplace and in executive decision making. Sweden, France, Netherlands, Spain, Norway, Chile, Denmark and Finland are examples of countries where feminine culture prevails. In fact, most European nations fall on the feminine side.

Japan, Germany, UK, Italy, Mexico, USA are masculine countries. There is low participation of women in executive cadre. As far as India is concerned, on the masculinity scale, India falls slightly above the median.

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In international business negotiations, business counterparts from the feminine nations may be more susceptible to gentle persuasion and warmth than by overt assertiveness. Lots of mental adjustment is needed for a delegation from a highly masculine country to successfully negotiate with the delegation from a foreign country that is predominantly feminine.

Europeans work as hard as Americans but they work in order to live. The American and European cultures are different on the masculine-feminine dimension.

Increasing intensity of international business is having a leveling effect across the world. The outer structures of cultures are crumbling; inner cores of basic values are hard to be changed. Intercultural management will continue to remain an important part of international business.

Today, international business is growing like never before. The various cultures are able to interact like never before. The cultures are mingling and changing. If businesses can study the differences between cultures, then they can better adapt themselves.

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17 LANGUAGE AS A COMPETITIVE WEAPON IN INTERNATIONAL BUSINESS

LEARNING OUTCOMES

- To understand the importance of language as a component of culture
- To examine the differences between high context and low context cultures

INTRODUCTION

Language may be used as a competitive weapon in international business. Language is a key component of culture and represents primary means of transmission of ideas and information – it facilitates social interaction, fosters a system of shared values and norms. Spoken language acts as a common thread and barrier between nations and regions. The communication challenges faced by international business managers can be resolved if they understand the importance of language.

Manager may speak and understand the language, but he may not understand the nuances of meaning. Manager has to rely on the services of a translator who may not be equally fluent in both languages. Understanding of local language allows usage of implied meanings and nuances. Direct translation may be inadequate or misleading.

Low context cultures are those where communication is clear and direct; speakers come straight to the point, say exactly what they mean – American culture. High context cultures are those where much goes unsaid. Depending on the relationship between the speakers, each is able to read between the lines and interpret body language.

ADVANTAGES OF LANGUAGE

Language diversity influences management decisions in modern multinational enterprises.

When a manager knows the language, there is clear and explicit understanding of the situation and so there is no need to rely on someone else to interpret or explain things.

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Language provides direct access to local people. Language is defining characteristic of culture. Language has both spoken and unspoken dimensions in countries with more than one language, more than one culture.

Language helps define culture. International business efforts need to develop cross cultural literacy; understand what the cultural differences mean for the business. Knowing language facilitates understanding the local culture and leads to national competitive advantage.



CONNECTION BETWEEN CULTURE AND ETHICS IN DECISION MAKING

International businesses that are ill-informed about the practices of another culture are likely to fail. Employing locals can be immensely beneficial. Home country executives must be cosmopolitan enough to understand how differences in culture affect the practice of international business. Managers should not succumb to the lure of practising Ethnocentrism. Ethnocentrism is a belief in the superiority of one's own ethnic group or culture. Language and culture affect competitive advantage – there is greater cooperation between management and labour and more focus towards work.

The connection between culture and competitive advantage depends on the choice of countries in which to locate production facilities and do business. A company has to choose between country A and B for locating a production facility – both countries are characterized by low labor costs and good access to global markets

Country A – education system undeveloped, society is marked by upper and lower class stratification and there are 6 linguistic groups.

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Country B – education system well developed, social stratification lacking, group identification valued by culture and there is only one linguistic group.

Country A will be characterized by conflict between management and labour and between different language groups – social & industrial disruption, thereby raising the costs of doing business. Cultural factors suggest that in the long run, country B is the nation most likely to achieve the greatest level of economic growth.



Learning host country language builds rapport and sets the proper tone for doing business abroad. Knowing the language helps in negotiations with overseas suppliers/ buyers. It can motivate and inspire sub ordinates. When a manager learns language, locals tend to accept him faster. Thus, language can be considered as a competitive weapon in international business.

For international business, the connection between culture and competitive advantage indicates which countries are likely to produce the most viable competitors. It is also indicative of which countries where the production facilities can be located. Multinationals are becoming increasingly conscious of the importance of global co-ordination and dealing with cross cultural issues effectively. Language remains a barrier in aspirations of a business to achieve harmonization in its attempts to enter a foreign market.

As technology becomes all-pervading and provides access to global talent and revenue, effective multilingual communication becomes a determinant of productivity in an organisation's attempts to achieve success in its international business efforts.

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18 ROLE OF NEGOTIATIONS IN INTERNATIONAL BUSINESS

LEARNING OUTCOMES

- To understand the importance of negotiations in international business
- To identify the sources of strength of a multinational enterprise taking part in the negotiation process
- To examine the cultural challenges in international negotiations

INTRODUCTION

Negotiation is essentially about use of dialog to resolve disputes and reach mutual agreement. The word "negotiation" is from the Latin expression, "negotiatus", which means "to carry on business". Negotiation is also often described using four elements

1. Strategy – focus on top level goals
2. Process - steps to be followed
3. Tools- techniques to be deployed
4. Tactics – detailed statements and actions and responses to actions by others

Business propositions of multinational enterprises are evaluated by home and host countries based on their own perceptions. For example – countries would like to know size, location, nature of product, pricing etc. Today countries are more concerned that activities of multinational corporations should not lead to environmental degradation. When mutual agreement appears to be challenging, negotiations become necessary.

By and large, multinational corporations prefer to comply with the stipulations of the host government. Occasionally they may try to repudiate the regulations. So long as regulations facilitate their business operations in the host country, multinational enterprises do not seem to have much of an objection. If there are any regulatory loopholes, foreign companies tend to take advantage of the same.

Differences between host country and a multinational enterprise (MNE) can result if they are attempting to control assets that are useful to the other. The bargaining relationship between the two depends on whether the parties view agreements as zero-sum or positive

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sum solutions. Zero-sum solution is where one party gains and the other party loses. In a positive sum solution, both parties stand to gain.

MNEs that can market the win-win possibilities well can deal with hostile foreign countries better. A nation that has natural resources, skilled labor, sound infrastructure and good governance is attractive to foreign investors. The market potential in the nation also plays a decisive role in selecting that nation. The political climate also influences the decision. Countries like United States, Canada, UK, France, Japan, Germany, Singapore and South Korea have higher bargaining strength.

Though developed nations were attractive avenues for investment, as they became choosy – attention of investors was diverted to BRICS nations (Brazil, Russia, India, China and South Africa). Some of these nations attract the MNEs by offering subsidies and tax holidays.

BARGAINING STRENGTH OF MNES LIES IN THE CORE COMPETENCE OF THEIR BRAND

The MNEs that have better bargaining power have the following characteristics

- Global presence
- Competitive position in the market
- Brand equity
- Financial strength
- Access to technology
- Marketing excellence
- Process Expertise
- Product diversity
- Large capital

There are instances of domestic companies that exert pressure on governments to thwart competition from multinational enterprises. They say that as they are technologically backward, absence of a level playing field will lead them to lose their competitive edge in the market. In some nations, the entry of MNEs has been opposed due to jingoism and flaring of the son-of-the-soil sentiments issue.

Host governments have been known to use such sentiments to their advantage by extracting more concessions from MNEs. Today, in a globalized world, no nation can reject entry of MNEs. At the same time, governments are also duty bound to protect the interest of domestic industry. The relation between governments and businesses is emerging stronger

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and so governments feel a sense of obligation. For example – UK put restrictions on imports of T-shirts from Indonesia after there was pressure from the garment industry in UK. Indonesia did not keep quiet. They retaliated by denying the construction of a British-owned critical project.

In 2010, GMR Infrastructure, an Indian company, had won a contract to modernize the airport in Maldives. In 2012, this contract was repudiated by Maldives government when there was a change in political regime. The company approached a three-member international tribunal and the company was awarded a compensation of $ 270 million.

ROLE OF NEGOTIATIONS IN INTERNATIONAL BUSINESS

Negotiations are always implemented through face to face negotiations. Whether it is sales of goods and services, licensing and franchise agreements or strategic alliances – all these require managers from different cultures to sit and talk with one another to exchange ideas and express needs and preferences.



A successful negotiation is one that involves detailed analysis of commercial and technical aspects along with the cultural aspects. Negotiation is both an art and a science. Analysis of bargaining strengths and strategies of the other party becomes important. Negotiation is also about successfully managing relationships through exemplary interpersonal skills and ability to convince and be convinced. Understanding of the regulations, culture and national norms is equally important in international business negotiations.

1. Negotiations help in arriving at a win-win situation.
2. Negotiations help in avoiding situations that can lead to a potential conflict.
3. They also help in the parties to empathize with one another.

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4. They help the MNE to better understand the regulations and cultural influences in the host country.
5. It is due to negotiations that the host country understands the value proposition offered by the MNE.

THE ADVOCATE'S APPROACH TO NEGOTIATION

In the advocacy approach, a skilled negotiator acts an advocate for one party to the negotiation to achieve the most favorable outcomes. The negotiator determines the minimum outcomes the other party is willing to accept and then the demands are adjusted accordingly. Advocacy approach is all about understanding the opponent well. The negotiation is deemed successful when most outcomes are achieved.

TEN NEW RULES FOR GLOBAL NEGOTIATIONS ADVOCATED BY HERNANDEZ AND GRAHAM

Accept only creative outcomes

Understand cultures, especially your own.

Don't just adjust to cultural differences, exploit them.

Gather intelligence.

Design the information flow and process of meetings.

Invest in personal relationships.

Persuade with questions. Seek information and understanding.

Make no concessions until the end.

Use techniques of creativity

Continue creativity after negotiations

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EMOTIONS IN NEGOTIATION

Emotions play an important role in the negotiation process. They have the potential to play a positive or negative role in the negotiation. Negative emotions can be irrational and lead to escalation in conflicts. Positive emotions facilitate reaching an agreement and help to achieve synergies.

CULTURAL PROBLEMS IN INTERNATIONAL NEGOTIATIONS

International business negotiations offer suffer from problems due to cultural differences

1. Language and non-verbal behaviors
2. Values
3. Thinking and decision making processes

If negotiators can't communicate in a common language then this can be challenging. Semantic differences can complicate matters. Same words may have different meanings in different cultures. What is considered as harmless in one culture may be inimical in another culture.

Cross-cultural differences in non verbal communication can be irksome. The Thumbs-Up signal is considered favorably in US, Britain and Russia. But the same signal is considered derogatory in Iran and Australia. Japanese are very formal. Americans are more informal. For some cultures, punctuality is sacrosanct but other cultures may have a casual approach towards adhering to disciplinary norms. Business ethics vary from one region to another.

In a collectivist culture like Japan, decision by consensus is the norm. USA and Sweden take decisions based on quantity of information that they have. French, Italian and Argentinean managers rely on past experience and qualitative information. Managers from US, Germany and Scandinavia have highest tolerance. Managers from Japan and Italy have lower tolerance for making decisions when there is uncertainty. These differences in tolerances can impact decision making.

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19 CONFLICT IN INTERNATIONAL BUSINESS

LEARNING OUTCOMES

- To examine the reasons for conflict in international business operations
- To review the strategies for resolving conflicts
- To understand the role of cultural factors in resolving conflicts

INTRODUCTION

Conflict generally refers to a situation where two or more parties have a disagreement in terms of their needs, interests and values. Conflict management is a strategic approach to resolve disputes and cultural factors seem to have an upper hand in successful resolution of the conflict at an early stage.

Conflict can result due to community issues, diplomatic issues, interpersonal issues or organizational issues. Religious issues can also lead to conflicts. There can be conflict between headquarters and subsidiary. An ethnocentric approach can lead to employees in subsidiaries getting disgruntled because they may feel that their freedom is stifled. A conflict can result due to differences in value system or due to prior experiences that were adverse. An impulsive approach to resolve the conflict can sometimes become counterproductive too. Performance issues can lead to conflict and so can mis managed expectations between headquarters and subsidiaries. There can be a conflict between subsidiaries due to competition over resources.



More entrepreneurs are going global. The modern business environment is getting globally interconnected. When a company enters a foreign market, it looks forward to valuable partnerships, avenues for sharing knowledge and leverage opportunities to scale up operations.

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However, there are risks too in the form of regulatory challenges and cultural barriers. Understanding the cultural factors has become increasingly important to avoid conflicts or resolve conflicts before they assume gigantic proportions.

Once there is a conflict, the goal should be – how to resolve this? Research has revealed that Western nations respect directness while Eastern nations look forward to an indirect approach to resolve conflicts. An indirect approach is one where the aim is to promote social harmony. The Western nations tend to give more preference to business matters than personal feelings or emotions.



COMMON CHARACTERISTICS OF INDIRECT CONFRONTATION STYLE

If you grew up in the Western hemisphere, you might be inclined to try to tackle conflicts head-on. Direct, forthcoming explanation of the issues at hand and your expectations might seem like the most respectable course of action, but it is important to first consider your audience.

Western businesses prefer tackling conflicts head-on without beating about the bush. So, the other side has to be ready with their defenses. Eastern sides of the globe focus more on interpersonal relationships and avoid any overt actions. They do not mind tendering apologies and prefer to have a third party to resolve the conflict right from the beginning.

It has been found that an indirect confrontation is usually more successful than a direct approach. So, in case we have a conflict between Americans and Chinese, one side has to adopt a different approach depending on who is at the receiving end.

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STRATEGIES TO RESOLVE CONFLICT

1. ACCOMMODATING
2. AVOIDING
3. COLLABORATING
4. COMPETING
5. COMPROMISING

The accommodating strategy involves looking at the problem with empathy with intent to resolve the conflict. There is more focus on relationships. The strategy of avoiding involves staying away from confrontation but it may appear as more diplomatic. Collaborating is a strategy that works well when tough problems have to be handled. Collaborators know how to use negotiations in a productive manner; however they can also go overboard and convert simple issues into more complex ones. Among all the five strategies, a competing strategy can be considered as more dominant as the players feel that they have a greater chance of winning in the negotiation. In this strategy, the focus on relationships is lost. A compromising strategy is useful when there is limited time to complete the deal. Compromisers are eager to close the deal as quickly as possible by ensuring a win-win situation. However, the flip side is that compromisers tend to rush the negotiation process and make concessions too quickly.

The global economic crisis in 2008 made managers wonder about sustaining long term competitive business strategy. Conflict in international organizations challenges competitive strategies and highlights the failure in group interactions and productivity.

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Solving conflict at international business organizations through global leadership styles will lead to greater organizational commitment, job satisfaction and participation. Leadership plays a crucial role in the stability of international business operations and also in resolving conflict in multicultural businesses. Group interactions, team work, learning skills and leadership styles play a definitive role in successful resolution of international business conflict.

One of the strategies to deal with conflicts involving American businesses is to make them wait. Americans place greater value on time and have less patience. Western businesses also tend to break large tasks into smaller tasks. For example – issues involving pricing, delivering and warranty may be settled one issue at a time. In Asia, all issues are discussed at once.

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20 ROLE OF INTERNATIONAL AGENCIES IN CONFLICT RESOLUTION

LEARNING OUTCOMES

- To understand the role of international agencies in resolving conflicts among nations
- To examine the role of WTO in resolving disputes.

International agencies perform the role of preventing conflicts.

The United Nations Code of Conduct for Transnational Corporations, 1983: This code gives comprehensive recommendations regarding the behavior of multinational corporations and host countries in preventing conflicts. The coverage of these codes include: respecting the national sovereignty of host countries, adhering to economic and social goals of nations, observing domestic laws, respecting human rights, refraining from engaging in corrupt practices, disclosing information to host government etc.

UNCTAD codes: United Nations Conference on Trade and Development Codes include negotiations to achieve common approaches to control restrictive trade practices, dissemination of information on restrictive business practices, flexibility to relax the rules of developing countries to encourage technology transfer and foreign investment.

The OECD code of practice on MNC operations: The 1976 declaration sought to encourage MNCs to contribute positively to the economic and social development of the host nations. The provisions of this declaration include: contribution to host country's science and technology, refraining from acquiring dominant position in the host country, co-operating with tax authorities, encourage employee participation in management and contribute to the host country's balance of payments.

ILO DECLARATION FOR MNCS AND SOCIAL POLICY

This code was adopted in 1977 and deals with issues relating to employment, working conditions, vocational training, industrial relations, employee participation in management, employee consultations and providing information to workers' representatives. These codes

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help the MNCs and host countries to prevent conflicts and disputes among MNCs, host country business firms and host country governments.

DISPUTE SETTLEMENT IN WTO

WTO provides a powerful mechanism to solve trade disputes among member countries. The rules are set out in the WTO dispute settlement understanding (DSU). Disputes between or among member countries arise as one country adopts the trade policy that is viewed by other members as breaking the WTO agreements. A third group of countries may be interested because the outcome of the dispute settlement may also have an impact on them. The group of countries that enjoys rights in the hearing process of the case is labeled as 'third party'.

The WTO's Dispute Settlement Understanding (DSU) was arrived at due to ineffectiveness of a similar mechanism by GATT. The DSU was intended to deal with the challenges associated with the reduction and elimination of non tariff barriers to trade. The DSU establishes rules and procedures to manage the various disputes. The Dispute Settlement Body (DSB) consists of all WTO members, which administers dispute settlement procedures.

The different stages in dispute resolution are:

1. Consultations among member nations
2. Establishment of a Dispute Panel
3. Conciliation and Mediation
4. Report by the Panel
5. Drafting of Final Report
6. Review by Appellate Body
7. Implementation of Reports

ARBITRATION : Member nations can also seek arbitration within the WTO to address those disputes that deal with issues that are clearly defined by both parties.

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21 FUTURE OF INTERNATIONAL BUSINESS

LEARNING OUTCOMES

- To examine the future trends in international business operations
- To review the influence of technology in international business operations
- To understand the challenges faced by multinational enterprises
- To learn about the changes in communication technologies and their impact on international business operations

International markets are evolving rapidly. Western businesses are now looking at emerging markets to expand their business. Language and cultural factors will continue to play a prominent role in international business operations. Demographic factors in developing economies are attractive as compared to those in Western economies that are saturated and having an aging population.



International businesses will continue to face challenges of political uncertainty and instability. So, before expanding a new or unknown market, it is essential to understand economic and political risks. Regulatory changes, changes in governments, corruption and unstable policies can damage business prospects. In 2016, UK chose to leave the European Union. It was then felt that in international business, political, economic and environmental issues are becoming increasingly important.

Communication technologies have evolved. It is easier for consumers to access pricing and quality information; businesses are losing their pricing power. Earlier, the power to engineer innovations was with the Western world. Now businesses in developing countries have acquired competence to develop world class innovations.

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Companies that wish to grow their international business operations need to assess the environmental impact of their operations. While Western economies have grown and become saturated, the real thrust of economic growth is seen in emerging economies like India, China and Brazil. However, even in these economies, growth is slowing down due to various reasons – as world markets get integrated, the shocks in one part of the world will reverberate in other parts as well. Businesses will be under pressure to maintain profitability in the face of slower economic growth across the globe. Emerging markets offer benefits of lower labor costs so western firms have to innovate at a higher speed and also use automation to improve their business operations.



The most common mistake made by multinational enterprises is that they are always focused on the short term. Their strategic orientation seems to be blinded by the prospect of attractive tactical gains. Panasonic invested in a fire safety company in Bangalore, India without a proper due diligence. The said company had sacked many employees because their business model was becoming unviable. Though other investors had invested in this business, lack of financial transparency led to the financial ruin of this company. Barely a few years after it got involved, Panasonic quit this organisation selling its shares back to the original promoter who got the shares dirt cheap. Panasonic never seemed to have analyzed the reasons why the company had landed itself in such a sorry state. The role of business leaders will become more pronounced in the days to come and they will become more accountable.

Expanding business in foreign shores also involves having a robust recruitment policy and HR practices that are flexible to suit the requirements of geographies across the globe.

Tax compliance in international business operations is crucial. Vodafone had a major tussle with Indian government and now Google is in the line of fire. Different tax systems, rates and compliance formalities in different parts of the world can be challenging for international business operations. The costs of doing international business operations can impact profitability. The cost of production and shipping, labor, marketing, and distribution, as well as your margin, must be looked at to ensure that business is viable.

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Swedish furniture giant Ikea, known in Europe for low cost value had to struggle in China due to intense competition. Local players had a competitive edge due to lower labor costs and lower production costs. Ikea cut prices by using locally sourced materials and relocating production to China so that their operations could be profitable.

Facebook is banned in China. Huawei and US government have declared a war against each other and it is affecting other nations. Chinese video maker Tik Tok is under close scrutiny of the Indian government. Indian company called GMR had bagged a contract in Maldives but when the government changed in Maldives, their contract was abruptly terminated and the contract was offered to a Chinese company.

Fluctuating currency rates can also adversely impact international business operations. Choice of shipping method can affect business revenues. Developing cross-cultural communication abilities is going to be game changer in the future.

Coca Cola has a business structure that is very well mapped with its operations across the world. The company has continental groups – each group is managed by a President. Central Presidents manage the regional sub divisions. The brand and product, is however, centrally controlled.

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In 2014, Airbnb had to pay a fine of a €30,000 fine for a breach of local tourism laws in Barcelona. Gaining a comprehensive understanding of local laws and regulations in target markets is vital.

Companies doing business in US must follow and comply with Foreign Corrupt Practices Act. The Act aims at eliminating bribery and unethical practices in international business.

There are examples of successful brands who simply couldn't sustain in a foreign market simply because the business model was unviable. Starbucks struggled in Australia because demand for local coffee shops was such that the brand value of Starbucks was of little help.



Companies have had to rethink their brand names. The Chevrolet Nova faced hurdles in Spain because Nova in Spanish means "no go". Managing suppliers and supply chains can be onerous especially when you have to deal with them in a foreign market.



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Information revolution in the last two decades has led to globalization resulting in integration of markets across the globe. Businesses hoping to scale up business by leveraging opportunities in foreign shores had to look at product and brand adaptation, management of internal operations, understanding consumer preferences, managing global relationships as well as deal with challenges associated with global sourcing.

Global progress has benefited some and harmed many. For example – many Indian companies have taken a wrong inspiration from American policies of hire and fire. Advanced health care services have led to an aging population with decreased mortality rates. But job security will continue to be a mirage. Stress levels have increased manifold.



Globalization has been a major driver of growth. Technological progress has improved transportation and communication. As businesses contribute to shareholder value, they are also becoming aware of community issues. Corporate social responsibility has become a necessity today. Despite all the euphoria about a growth driven economy, the gap between haves and have-nots has only widened. Automation is threatening to replace jobs that need human labor.

Business leaders must ensure that their businesses are profitable and also secure conditions for sustained prosperity. There is a need for the business model to be more inclusive to achieve success in global economic integration efforts.

In his 2016 speech at New York University, Jeff Immelt, the former CEO of GE said that globalization is now geographically differentiated and digitally interconnected. The focus has now shifted to building local capabilities and businesses becoming more socially responsible.

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Jeff Immelt – Former CEO of GE

Business leaders have to now look beyond cost-based off shoring. They should evaluate the benefits of trade and technology across a wider geographic and demographic base. Advanced production methods, shifting production closer to end markets, analytics are some of the future trends. Companies like Adidas, Zara and Tesla are moving production closer to customer demand.

Growth of exports in developing countries is due to technology intensive products. The growth in procurement in south-east Asia is because they have been able to absorb, adapt and use new technology better. The less developed countries like Africa are making slow progress in future. There will be heightened R&D activity as the dominance of the developing countries increases.

Services would take advantage of the developments in communication technology and could be outsourced to low cost destinations. Several decades ago international business went in search of resources. Just a few decades ago, the focus of IB has shifted to technological products. The focus is now on services. In the next 20 to 30 years it is hoped that the focus shifts to subtler needs like psychological needs. As more and more business organizations expand the scope of their international business operations, it is hoped that it will lead to a better appreciation of the environmental and ecological issues that have no political boundaries across nations.

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Liberalization of trade and investment coupled with rapid advances in technology has contributed to the growth of international business. World Trade Organization was formed in 1995. Electronic fund transfers, movement of euro to the European Union, technological innovations in communication and transportation – these developments signify the relevance of international business operations today.

The advent of multinational corporations and transnational corporations has led to increased competition across the globe. Even a small company can export its products and take part in international business activities. Due to differing laws, regulations, taxes, duties, currencies, cultures and business practices, international business is much more complex. If this complexity is managed well, businesses can survive and sustain in the market. Businesses must be aware of economic and political risks. They must acclimatize themselves to the culture in the host country.

To ensure success in a foreign market, international businesses must understand the factors that affect the competitive environment, assess their impact and plan their strategies accordingly.

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