For B.Com., III Semester, Bangalore University

International Business Environment

P. Subba Rao

Himalaya Publishing House

International Business Environment

(Strictly written according to Syllabus of Third Semester B.Com. Bangalore University)

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PREFACE

Globalisation brought significant paradigm shifts in the business arena both at the home as well as in various foreign countries. Consequently the concept of business and the principles of business management both at the home as well as in various foreign countries have changed dramatically. In fact business at the global level has been narrowing down the gaps in business practices in various countries.

The concept of global village resulted in exchange of cultures across the globe, location of manufacturing centres in various countries by treating the entire globe as a single country, producing the components in one country, assembling the product in the second country and the market the product in the third country, the banks in the fourth country finance the operations and the insurance companies in the fifth country provide the insurance facilities and so on so forth. Added to this the customer by staying in one country, buy the products from any country in the world.

This complex process has become reality due to information technology and electronic business. These significant and crucial landmarks widened the arena of domestic business to international business. Further the scope of international trade and international marketing is enlarged into international business.

Consequently, the significance of international business is manifested. A number of Indian business schools have started introducing a subject/course on "International Business" in their MBA program. Of late a number of Universities started introducing this subject/ course even at under-graduate level like Bangalore University. In fact, many foreign Universities like the University of Papua New Guinea, introduced this subject at under-graduate level during 1990s.

This book is written based on the " International Business Environment", syllabus of B.Com., course of Bangalore University.

I thank the authorities of the University of Papua New Guinea for encouraging me to write this book. I thank Shri D.P.Pandey of Himalaya Publishing House for his continuous support. I specially thank Sri Neraj Pandey and his team of Himalaya Publishing House for encouraging me to write this book. My thanks are also due to Ms. Krishnaveni of Himalaya Publishing House for her untiring effort in contacting me and providing input electronically. Finally, I am grateful to Madhu for bringing this book nicely in a short span of time.

24th April, 2005

Prof.P. Subbarao
Port Moresby, Papua New Guinea

SYLLABUS

UNIT 1 : Evolution of International business – characteristic features of International business – factors affecting the international business – Changing scenario of International Business.

UNIT 2: International Business Environment – economic – political – legal, social – culture, Technological

UNIT 3 : Multinational corporations – Global companies – international business houses – concepts, structures and functions.

UNIT 4 : International finance; Foreign Exchange – convertibility of rupee (Basics) forex market – structure and functions. World Bank, IMF, UNCTAD

UNIT 5 : International Marketing: product – packing – promotion

UNIT 6 : International Human Development: recruitment – selection and development policies.

UNIT 7 : Regional Trading Blocks: EU, NAFTA, SAARC, WTO

SKILL DEVELOPMENT:

I. List atleast 3 MNCs of G-7 Countries operating in India along with products they manufacture.

II. Preparation of a chart on different currencies of different countries.

III. Table of atleast one month data of Foreign exchange rate of atleast 2 currencies.

IV. Latest news affecting India through WTO, World Bank, IMF etc.

V. Chart of product life cycle of International product.

VI. Description of procedures followed in recruitment / selection of atleast one MNC in India.

CONTENTS

Unit One

INTERNATIONAL BUSINESS

CHAPTER OUTLINE

Introduction

The beverages you drink might be produced in India, but with the collaboration of a USA company. The tea you drink is prepared from the tea powder produced in Sri Lanka. The spares and hard-disk of the computer you operate might have been produced in the United States of America. The perfume you apply might have been produced in France. The television you watch might have been produced with the Japanese technology. The shoes you wear might have been produced in Taiwan, but remarketed by an Italian company. Your air-travel services might have been provided to you by Air-France and so on so forth.

Most of you have the experience of browsing internet and visiting different web sites, knowing the products and services offered by various companies across the globe. Some of you might have the experience of even ordering and buying the products through internet. This process gives you the opportunity of transacting in the international business arena without visiting or knowing the various countries and companies across the globe.

You get all these even without visiting or knowing the country of the company where they are produced. All these activities have become a reality due to the operations and activities of international business.

Thus, international business is the process of focusing on the resources of the globe and objectives of the organisations on global business opportunities and threats, in order to produce, buy, sell or exchange of goods/services world-wide.

(A) EVOLUTION OF INTERNATIONAL BUSINESS

The origin of international business goes back to human civilization. Historically periods of greater openness to trade have been characterized by stronger but lopsided global growth. The concept of international business-a broader concept relating to the integration of economies and societies, dates back to the 19th century. The first phase of globalization began around 1870 and ended with the World War I (1914) driven by the industrial revolution in UK, Germany and USA. The import of raw material by colonial empires from their colonies and exporting finished goods to their overseas possessions was the main reason for the sharp increase in the trade during this phase.

The ratio of trade to GDP was as high as 22.1 in 1913. Later various Governments initiated and imposed a number of barriers to trade to protect their domestic production that led to decline in the ratio of trade to GDP to 9.1 during 1930s.The international trade between two world wars has been described as " a vast game of beggar-my-neighbour."

Advanced countries experienced sever set back consequent up on the imposition of trade barriers as they produce in excess of domestic demand and a decline in the volume of international trade. Added to this, the break down of the gold standard resulted in vacuum in the field of international trade. Then the world nations felt for the need for international cooperation in global trade and balance of payments affairs. These efforts resulted in the establishment of International Monetary Fund (IMF) and International Bank for Reconstruction and Development (IBRD-popularly known as the World Bank).

The prolonged recession before the World War II in the west, led to and international consensus after the World War II that a different approach towards international trade was required. Consequently 23 countries conducted negotiations in 1947 in order to prevent he protectionism policies and to revive the economies from recession aiming at the establishment of the International Trade Organization. This attempt of the advanced countries ended with the General Agreement on Trade and Tariffs (GATT) that provided a framework for a series of 'rounds' of negotiations by which tariffs were reduced. Efforts to convert the General Agreement on Trade and Tariffs (GATT) into World Trade Organization (WTO) were intensified during 1980s and ultimately GATT was replaced by the WTO on 1st January 1995.envisaging the trade liberalizations. The efforts of IMF, World Bank and WTO along with the efforts of individual countries due to economic limitations of the closed economies led to the globalization of business. Globalization gave fillip to international business particularly during 1990s.

In fact, the term international business was not popular before two decades. The term international business has emerged from the term 'international marketing', which, in turn, emerged from the term 'international trade.'

International Trade to International Marketing: Originally, the producers used to export their products to the nearby countries and gradually extended the exports to far-off countries. Gradually, the companies extended the operations beyond trade. *For example,* India used to export raw cotton, raw jute and iron ore during the early 1900s. The massive industrialisation in the country enabled us to export jute products, cotton garments and steel during 1960s.

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

International Marketing to International Business: The multinational companies which were producing the products in their home countries and marketing them in various foreign countries before 1980s, started locating their plants and other manufacturing facilities in foreign/host countries. Later, they started producing in one foreign country and marketing in other foreign countries. *For example,* Uni Lever established its subsidiary company in India, *i.e.,* Hindustan Lever Limited (HLL). HLL produces its products in India and markets them in Bangladesh, Sri Lanka, Nepal etc. Thus, the scope of the international trade is expanded into international marketing and international marketing is expanded into international business.

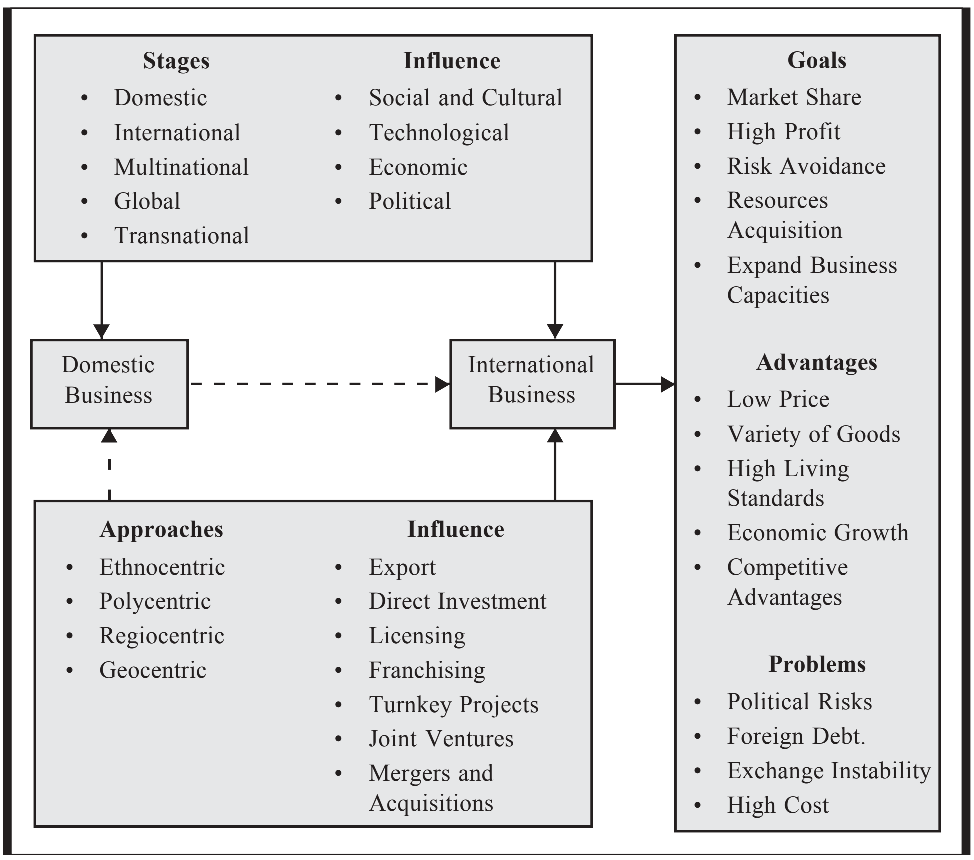

Fig. 1.1 : International Business Model

The 1990s and the new millennium clearly indicate rapid internationalisation and globalisation. The entire globe is passing at a dramatic pace through the transition period. Today, the international trader is in a position to analyse and interpret the global, social, technical, economic, political and natural environmental factors more clearly. *Figure 1.1* presents influencing environmental factors, stages, approaches, and modes of entry, goals of and advantages of international business.

(B) CHARACTERISTIC FEATURES OF INTERNATIONAL BUSINESS

Conducting and managing international business operations is a crucial venture due to variations in political, social, cultural and economic factors, from one country to another country. *For example*, most of the African consumers prefer less costly products due to their poor economic conditions, whereas the German consumers prefer high quality and high priced products due to their higher ability to buy. Therefore, the international businessman should produce and export less costly products to most of the African countries and *vice versa* to most of the European and North American countries. High priced and high quality Palmolive soaps are marketed in European countries and the economy priced Palmolive soaps are exported and marketed in developing countries like Ethiopia, Pakistan, Kenya, India, Cambodia etc. Characteristic features of international business include:

- **Accurate Information**: International business houses need accurate information to make an appropriate decision. Europe was the most opportunistic market for leather goods and particularly for shoes. Bata based on the accurate data could make appropriate decision to enter various European countries.
- **Timely Information**: International business houses need not only accurate but timely information. Coca-Cola could enter the European market based on the timely information, whereas Pepsi entered later. Another example is the timely entrance of Indian software companies into the US market compared to those of other countries. Indian software companies also made timely decision in the case of Europe.
- **Size of the Business**: The size of the international business should be large in order to have impact on the foreign economies. Most of the multinational companies are significantly large in size. In fact, the capital of some of the MNCs is greater than our annual budget and GDPs of the some of the African countries.
- **Market Segmentation**: Most of the international business houses segment their markets based on the geographic market segmentation. Daewoo segmented its market as North America, Europe, Africa, Indian sub-continent and Pacific markets.

Potentiality of Markets

- International markets present more potentials than the domestic markets. This is due to the fact that international markets are wide in scope, varied in consumer tastes, preferences and purchasing abilities, size of the population etc. *For example,* the IBM's sales are more in foreign countries than in USA. *Similarly,* Coca-Cola's sales, Procter and Gamble's sales and Satyam Computer's sales are more in foreign countries than in their respective home countries.

  The population for the year 2000 indicates that: USA's population would be 300 million, Mexico's 126 million, Brazil's 205 million, Indonesia's 223 million, Pakistan's 138 million, Nigeria's 154 million and Bangladesh's 146 million.

  The size of the population, sometimes, may not determine the size of the market. This is due to the backwardness of the economy and low purchasing power of the people. In fact, the size of Eritrea – an African country is roughly equal to that of the United Kingdom in terms of land area and size of the population. But, in terms of per capita income it is one of the poorest countries in the world with an estimated per capita income of US $ 150 per annum.

  Therefore, the international business houses should consider the consumers' willingness to buy and also ability to buy the products.

  In fact, most of the multinational companies, which entered Indian market after 1991, failed in this respect. They viewed that almost the entire Indian population would be the customers. Therefore, they estimated that the demand for consumer durable goods would be increasing in India after globalisation. And they entered the Indian market. The heavy inflow of these goods and decline in the size of Indian middle class resulted in a slump in the demand for consumer durable goods.

  Therefore, the international business houses should accurately estimate the size of the customers who are willing and able to buy the products/services rather than just the size of the population of the foreign countries.

- **Wider Scope :** Foreign trade refers to the flow of goods across national political borders. Therefore, it refers to exporting and importing by international marketing companies plus creation of demand, promotion, pricing etc. As stated earlier, international business is much broader in its scope. It involves international marketing, international investments, management of foreign exchange, procuring international finance from IMF, IBRD, IFC, IDA etc., management of international human resources, management of cultural diversity, international marketing, management of international production and logistics, international strategic management and the like. Thus, international business is broader in scope and covers all aspects of the system.]

- **Inter-country Comparative Study :** International business studies the business opportunities, threats, consumers' preferences, behaviour, cultures of the societies, employees, business environmental factors, manufacturing locations, management styles, inputs and human resource management practices in various countries. International business seeks to identify, classify and interpret the similarities and dissimilarities among the systems used to anticipate demand and market products. The system presents inter-country comparison and inter-continental comparison. Comparative analysis helps the management to evaluate the markets, finances, human resources, consumers etc. of various countries. The comparative study also helps the management to evaluate the market potentials of various countries.

The study also indicates the degree of consumer acceptance of the product, product changes and developments in different countries. Managements of international business houses can group the countries with similar features and design the same products, fix similar price and formulate the same marketing strategies. *For example,* Prentice-Hall grouped India, Nepal, Pakistan, Bangladesh, Sri Lanka etc. into one category based on the customers' ability to pay and designed the same quality product and sold them at the same price in all these countries. *Similarly,*, Dr. Reddy's Lab does the same for its products to sell in the African countries.

Differences In Government Policies, Laws And Regulations

Sovereign governments enact and implement the laws, and formulate and implement policies and regulations. The international business houses should follow these laws, policies and regulations. MNCs operating in India follow our labour laws, business laws and policies and regulations formulated by the Indian Government. *For example,* international business is required to enter into joint venture with the domestic company to enter Malaysia. Important among them include:

- **Host Country's Monetary System :** Countries regulate the price level, flow of money, production levels etc. through their monetary systems. In addition, they regulate foreign exchange rates also through the monetary system. The tools of monetary system include bank rate, cash reserve ratio, statutory liquidity ratio etc. Governments also regulate remittance of the profit of international business houses to other countries. International companies should obey these regulations. The Indian Government introduced full convertibility on current account; in fact, many Governments introduced full convertibility on current account as a part of economic liberalisation.
- **National Security Policies of the Host Countries:** Every country formulates the policies for its national security. Multinational companies should abide by these national security policies. *For example*, USA is a free economy as far as carrying out the business compared to many other countries in the world. However, USA also imposes restrictions regarding the business operations, which affect the national security.

- **Cultural Factors:** Cultural and custom factors vary widely from one country to another. These factors include dressing habits, eating habits; religious factors and the like *(See Box 1.1)*. Multinational companies should consider these factors of the host country while operating in that country. *For example,* the culture of the Fiji people is that they attend to the family activities at least three times a day. Therefore, the companies operating in that country allow their workers to go home three times a day. *(See Box 1.2)*

BOX 1.1 **CHOICE OF EATING HABITS RESTS WITH CONSUMER**

Multi-national PepsiCo would like its food products classified under the "Good for you'' category to contribute fifty per cent of its total sales. According to Indra Nooyi, President and Chief Financial Officer of PepsiCo, the company grouped its products into three categories: `Fun for you,' which comprised products like Pepsi or Lays'; "Better for you,'' where PepsiCo removed the perceived negative elements out of a product and in its place introduced a new one like Diet Pepsi; and "Good for you,'' which included the Tropicana brand of juices.

In an interaction with journalists of *The Hindu* group of publications here today, Ms. Nooyi said that at present the 'Good for you' and 'Better for you' products accounted for 35 per cent and 'Fun for you' products the remaining 65 per cent.

Ms. Nooyi said the number of servings of the company's products in the U.S. had been going up — "Yet, the calories we sell have been going down.'' Companies like PepsiCo had a range of products in their portfolio, catering to different tastes of varied consumers. Observing that "the ownership of lifestyle is being transferred from individuals to corporations,'' she said that the choice of a product should be made by consumers. "Eat what you want. Drink what you want,'' she said. In this context, she referred to a current backlash in the U.S., where consumers asserted their right over the choice of eating habits.

Source: Adapted from http://www.hindu.com/2005/04/01/stories/2005040108541600.htm

BOX 1.2 **IMPACT OF CULTURE OF SWITZERLAND HOUSEWIVES ON MARKETING OF DISHWASHERS**

In Switzerland, foreign dishwasher manufacturers expected the same rapid sales as they had first obtained in other West European markets; but sales in Switzerland were so slow that research had to be done to find out why (this research should, of course, have been done before not after market entry). The research showed that the Swiss housewife had a different set of values compared to, her French and English counterparts; she was very conscious of her role as strict and hardworking and her responsibility for the health of her family. To the Swiss housewife dishwashers simply made life easy, and this conflicted with her Calvinistic work ethic. As a result of this research, dishwasher manufacturers had to change their advertising — promoting, instead of ease and convenience, hygiene and health. They did this by emphasising that because dishwashers used temperature higher than hand-hot, the process was more hygienic than washing up by hand. Thereafter, they had no problem selling automatic dishwashers in Switzerland.

Source: Edgar P. Hibbert, "International Business", Macmillan, 1997, p. 70.

- **Language :** Language is an important factor in international business. Even though 'English language' is a major language in business operations in the world, there are still a large number of 'non-English' speaking countries. Therefore, international business houses should train their employees in the local language of the host country. Added to this, there would be many languages in use in many countries like ours. Therefore, the business houses should train their employees in the local languages also.
- **Nationalism and Business Policy :** Nationalism is a dominating factor of the social life of the people of the host countries. In fact, nationalism also affects the business operations of the multinational corporations dramatically and drastically. The US people used the slogan, *'Be American and Buy American Made'*, when the US automobile industry failed to meet the competition of Japanese automobile companies operating in USA. Similar incidents are also observed in developing countries. Therefore, international business houses should be cautious of nationalism and its after effects.

Changing Scenario of International Business

The scenario of international business has been changing at a fast rate after 1990s. Many factors contributed to the changing scenario of international business. These factors include:

- Globalization of various economies including the former communist countries and socialist pattern of societies,
- Establishment of World Trade Organization on 1st January 1995 in the place of General Agreements on Trade and Tariffs,
- Information technology revolution and its wider applications to business across the globe,
- Higher growth rate of transport technology and consequent reduction in cost , increase in speed and efficiency,
- Enlargement of European Union from 15 members to 25 members
- Higher growth rate of GDP of China, India, South Korea, Singapore, Malaysia, Thailand, Brazil and Mexico.
- Spread of production activities of multinational companies in the newly globalised economies in addition to the developed economies,
- Increase in business alliances in degree and variety like alliances, joint ventures, mergers, amalgamations and takeovers,
- Increased globalisaion of culture
- Increase in educational opportunities and career-orientation among the people of developing countries particularly China and India. These factors resulted in enhancement of opportunities for higher value addition in developing countries. Consequently developing countries started attracting multinational companies to establish their manufacturing facilities in their countries.

(C) FACTORS AFFECTING INTERNATIONAL BUSINESS

Various economies including the former communist and socialist countries opened their economies to the rest of the globe. The shifts in globalization and international business have been at a fast rate after 1990s. The external environmental factors have been contributing significantly for the significant strides in global business. The drivers of globalization/ factors contributing to the globalisation include establishment of WTO, emergence and growth of regional integration, decline in trade barriers, decline in investment barriers, increase in FDI, technological changes and gowth of MNCs.

Establishment of World Trade Organisation: Governments of the member countries of General Agreement on Trade and Tariff (GATT) concluded the Uruguay round negotiations on the 15th December, 1994. The Ministers expressed their political support to the outcome of the meeting by signing the Final Act in Marrakesh, Morocco on the 15th April 1994. According to the Marrakesh declaration, the results of the Uruguay round would, "strengthen the world economy and lead to more trade, investment, employment and income growth throughout the world." The World Trade Organsiation was established with effect from 1st January 1995 in order to facilitate the implementation, administration and operation and further the objectives of this agreement and on the Multinational Trade Agreements and shall also provide the framework for implementation, administration and operation of the plurilateral Trade Agreements.

The value of exports increased by 57% and import increased by 61% after the establishment of WTO i.e., during 1995 and 2004.

Regional Integration

The regional and economic integration of the countries of the same region or areas increases the size of market, aggregate demand for products and services, quantity of production, employment and ultimately the economic activity of the region. Further, the people of the region get a variety of products at comparatively lower prices. This factor, in turn, enhances the purchasing power and living standards of the people. The significant regional integrations include European Union, NAFTA and ASEAN.

European Union

The European Economic Community is also known as European Common Market. Originally six countries, *viz.,* France, Federal Republic of Germany, Italy, Belgium, Netherlands and Luxembourg formed into the European Economic Community (EEC) by the Treaty of Rome, 1957.The number of member countries of the EEC increased from six to 15 by 30th April2004. The EEC by enlarging its scope and operations turned into European Union .On May 1, 2004 10 more joined

EU. Thus the membership of EU as on 30th April 2005 was 25. The EU has a common agricultural policy, common monetary policy and fisheries policy.

The EU has emerged as one market from January 1, 2002 with the introduction of a common currency i.e., Euro. The political national boundaries are erased for the business and economic activities — goods, services, people and capital can move freely from one country to another of the EU. Now, the member countries do not impose any import tariffs. Import tariffs of the member countries are replaced by the community tariffs system. This factor provides easy access of total EU to the exporters. Thus, the EU could create the largest, single market by removing the obstacles for the free movement of goods, services, persons and capital among the member countries of the EEC. The single market enlarged the production, trade, income, investment and employment in all the member countries. The balance of payments position of all the member counties has become strong.

European union alone accounts for 42% of the world exports (or US$ 3708 billion out of total global exports of US$ 8880 billion) and 41% of the world imports (or US$ 3784 billion out of US$ 9215 billion) in 2004. Thus European Union contributes significantly for the globalisation of international business.

NAFTA: The North American Free Trade Agreement (NAFTA) came into being on January 1, 1994. The most affluent nations of the world, *i.e.,* the USA and Canada along with Mexico – a developing country joined together to form a trade block. A free trade agreement was signed by the USA and Canada in 1989. This was extended to Mexico in 1994. NAFTA is expected to eliminate all tariffs and trade barriers among these countries by 2009. However, internal tariffs on a large number of product categories were removed already. NAFTA has a population of 363 million and hence it is one of the significant trading areas in the globe.

NAFTA countries account for 15% of the world exports (or US$ 1330 billion out of total global exports of US$ 8880 billion) and 22% of the world imports (or US$ 2010 billion out of US$ 9215 billion) in 2004. Thus NAFTA also contributes significantly for the globalisation of international business.

Similarly other regional integrations like ASEAN and SAARC also contributed for the growth of the global economy.

Declining Trade Barriers

Another significant driver of globalisation is the declining trade barriers. International trade occurs when the goods flow across the countries. Governments used to impose trade barriers like quotas and tariffs in order to protect domestic business from the competition of international business. Advanced countries after World War II agreed to reduce tariffs in order to encourage free flow of goods. The member countries of the General Agreement on Trade and tariff (GATT) in various rounds of negotiations agreed to reduce the tariff rates. The Uruguay round of negotiations contributed to further reduction of trade barriers and extension of GATT to cover manufactured goods and services.

Consequently USA reduced the rate of tariffs from 44% in 1913 to 14% in 1950, to 4.8% in 1990 and further to3.9% in 2000. Similarly, Japan reduced the rate of tariff from 30% in 1913 to 5.3% in 1990 and to 3.9%in 2000.Thus; most of the advanced countries reduced the tariff rates to 3.9% in 2000. The growth of international trade between 1950 and 2004 was about 25-fold. These reductions in tariff and other trade barriers contributed for the growth of global trade.

Declining Investment Barriers

Global business firms invest capital in order to establish manufacturing and other facilities in foreign countries. Foreign governments impose barriers on foreign investment in order to protect domestic industry. But, various countries have been removing these barriers on foreign direct investment in order to encourage the growth of global business. Various governments made 1,121 changes in the laws governing foreign direct investment between 1991 and 2000. Out of these amendments, 95% were in favour of foreign direct investment. In addition, bilateral treaties increased from 181 as of 1980 to 1,856 as of 2000 among 160 countries. These treaties, which were designed to promote and protect investment among countries, enabled the fast growth of globalisation of not only trade, but also production. Consequently, the global production increased by 7-fold between 19 50 and 2004.

Growth in Foreign Direct Investment

The investment made by a company in new manufacturing and/or marketing facilities in a foreign country is referred to as ‘Foreign Direct Investment (FDI). There are a number of reasons for the growth of FDI in recent years. These reasons include: increase in sales and profits, enter rapidly growing markets, reduce costs, consolidate trade blocs, protect domestic markets, protect foreign markets, acquire technological and managerial know-how.

FDI flows have increased dramatically during the last 25 years, with a rapid growth during 1990s.The outflow of FDI was more than 12 times after 1990s compared to that during 1970s. It increased from US$ 564 billion in 1980 to US$ 6,767 billion in 2002.The flow of FDI is expected to increase further once the world economy picks-up from its recent recession in advanced countries.

Advanced countries were the major players in the flow of FDI. They were the predominant providers and recipients of FDI as 87% of FDI was provided by advanced countries and they received 65% of the FDI in 2002.It indicated that developing countries provided only 13% of total FDI and received 35% of total global FDI in 2002. USA was the largest provider as well as recipient of FDI followed by UK in 2002.

Emerging economies are now receiving high FDI than what they received in 1980s. However, a few countries like China, Hong Kong, Brazil, Mexico, India and

Singapore are receiving over 50% of FDI among developing countries. Growth and spread of FDI enlarged the globalization of production and marketing.

Strides in Technology

Technological change is amazing and phenomenal after 1980s. In fact, it is like a revolution in case of telecommunication, information technology and transportation technology. Companies spread latest technology throughout the globe and technology itself makes the global company possible and fastens the process of globalisation. In addition, the latest developments in information technology have enabled the global company to develop into a virtual global company.

Microprocessors and Telecommunications: The development of microprocessors paved the way for the growth of high-power, superior-speed low cost computing and handling vast amount of information. These have been revolutionary changes in global telecommunications consequent upon the developments in microprocessors. The development in microprocessors and telecommunications improved the speed and efficiency of co-ordinating the operations of global business firms.

The Internet and World Wide Web: The internet and world wide web will be the backbone of future global business. The activities of the global companies across the globe are co-ordinated, monitored and controlled with the help of Internet. The various facilities of the Internet and World Wide Web like e-mail; voice mail, data, and real-time video communications such as video conferencing enable the global business companies to operate efficiently. *For example,* the executives of a new automobile company in India can visit the home page of the Japanese and US automobile companies by using www search engine and download information on product designs, specifications, models, price, service to the customers, market information etc. This new Indian automobile company can make use of the information in designing its cars and pricing them.

On-line Globalisation: The companies with manufacturing facilities throughout the globe can send information regarding changes in raw material, customer preferences, changes in product designs etc., through the internet all over the globe. Even the customer enquiries and complaints can be received and redressed through Internet.

Thus, the information technology enabled the globalisation process at a faster rate with more efficiency at low cost.

Transportation Technology: The significant development in transportation technology reduced the distance among the countries drastically. The important developments in the transport technology include: commercial jet aircraft, super fighters, containers etc. These developments made the transshipment from one mode to another easy and reduced the travel time from one country to another drastically.

Growth of Multinational Companies

A multinational corporation/company is an organisation doing business in more than one country. Transnational company produces, markets, invests and operates across the world. MNCs and TNCs have been growing and spreading their operations due to market, financial and other superiorities and the expansion of international markets.

USA had 185 out of 500 top MNCs in the world in 2000 followed by European Union (141) and Japan (104). Developing countries had around 35 MNCs among the top 500 MNCs in the world in 2000. MNCs also have been driving towards globalisation.

(D) CHANGING SCENARIO OF INTERNATIONAL BUSINESS

The above stated factors contributed for the significant change in the scenario of international business and resulted in the variations in the operations of international companies. These variations in the scenarios generally categorized into five stages viz., domestic company, international company, multinational company, global company and transnational company. Now, we study each scenario in detail.

Scenario - 1 : Domestic Company

Domestic company limits its operations, mission and vision to the national political boundaries. This company focuses its view on the domestic market opportunities, domestic suppliers, domestic financial companies, domestic customers etc.

These companies analyse the national environment of the country, formulate the strategies to exploit the opportunities offered by the environment. The domestic companies' unconscious motto is that, *"if it is not happening in the home country, it is not happening."*

The domestic company never thinks of growing globally. If it grows, beyond its present capacity, the company selects the diversification strategy of entering into new domestic markets, new products, technology etc. The domestic company does not select the strategy of expansion/penetrating into the international markets.

Scenario - 2 : International Company

Some of the domestic companies, which grow beyond their production and/or domestic marketing capacities, think of internationalizing their operations. Those companies who decide to exploit the opportunities outside the domestic country are the stage two companies. These companies remain ethnocentric or domestic country oriented. These companies believe that the practices adopted in domestic business, the people and products of domestic business are superior to those of other countries. The focus of these companies is domestic but extends the wings to the foreign countries.

These companies select the strategy of locating a branch in the foreign markets and extend the same domestic operations into foreign markets. In other words, these companies extend the domestic product, domestic price, promotion and other business practices to the foreign markets.

Normally internationalisation process of most of the global companies starts with this stage two process. Most of the companies follow this strategy due to limited resources and also to learn from the foreign markets gradually before becoming a global company without much risk.

The international company holds the marketing mix constantly and extends the operations to new countries. Thus, the international company extends the domestic country marketing mix and business model and practices to foreign countries.

Scenario - 3 : Multinational Company

Sooner or later, the international companies learn that the extension strategy (*i.e.*, extending the domestic product, price and promotion to foreign markets) will not work. The best example is that Toyota exported Toyopet cars produced for Japan in Japan to the USA in 1957. Toyopet was not successful in the USA. Toyota could not sell these cars in the USA as they were over priced, underpowered and built like tanks. Thus, these cars were not suitable for the US markets. The unsold cars were shipped back to Japan.

Toyota took this failure as a rich learning experience and as a source of invaluable intelligence but not as failure. Toyota based on this experience designed new models of cars suitable for the US market. The international companies turn into multinational companies when they start responding to the specific needs of the different country markets regarding product, price and promotion.

This stage of multinational company is also referred to as *multidomestic.* Multidomestic company formulates different strategies for different markets; thus, the orientation shifts from *ethnocentric to polycentric.* Under polycentic orientation the offices/branches/subsidiaries of a multinational company work like domestic company in each country where they operate with distinct policies and strategies suitable to the country concerned. Thus, they operate like a domestic company of the country concerned in each of their markets.

Philips of Netherlands was a multidomestic company of this stage during 1960s. It used to have autonomous national organisations and formulate the strategies separately for each country. Its strategy did work effectively until the Japanese companies and Matsushita started competing with this company based on global strategy. Global strategy was based on focusing the company resources to serve the world market.

Philips strategy was to work like a domestic company, and produce a number of models of the product. Consequently, it increased the cost of production and price of the product. But the Matsushita's strategy was to give the value, quality, design and low price to the customer. Philips lost its market share as Matsushita offered more value to the customer.

Consequently, Philips changed its strategy and created "industry main groups" in Netherlands which are responsible for formulating a global strategy for producing, marketing and R & D.

Scenario - 4: Global Company

A global company is the one, which has either global marketing strategy or a global strategy. Global company either produces in home country or in a single country and focuses on marketing these products globally, or produces the products globally and focuses on marketing these products domestically.

Harley designs and produces super heavy weight motorcycles in the USA and markets in the global market. Similarly, Dr. Reddy's Lab designs and produces drugs in India and markets globally. Thus, Harley and Dr. Reddy's Lab are examples of global marketing focus. Gap procures products in the global countries and markets the products through its retail organisation in the USA. Thus, Gap is an example for global sourcing company.

Harley Davidson designs and produces in the USA and gains competitive advantage as Mercedes in Germany. The Gap understands the US consumer and gets competitive advantage.

Scenario - 5: Transnational Company

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. There is no pure transnational corporation. However, most of the transnational companies satisfy many of the characteristics of a global corporation. *For example,* Coca-Cola, Pepsi-Cola etc.

CHARACTERISTICS OF A TRANSNATIONAL COMPANY

The characteristics of a transnational company include: geocentric orientation, scanning or information acquisition, long-run visions etc. We discuss these characteristics in detail.

(i) Geocentric Orientation: A transnational company is geocentric in its orientation. This company thinks globally and acts locally. This company adopts global strategy but allows value addition to the customer of a domestic country. This company allows adaptation to add value to its global offer. *Table 1.1* presents scenarios of international business.

The assets of a transnational company are distributed throughout the world, independent and specialised. The R & D facilities of a transnational company are spread in many countries, but specialised in each country based on the local needs and integrated in world R & D project. *Similarly*, the production facilities are spread but specialised and integrated.

In case of Caterpillar, manufacturing and assembly facilities are located in many countries. Components are shipped for assembly and the assembled product is shipped to the place of the customer.

TABLE 1.1 SCENARIOS OF INTERNATIONAL BUSINESS

Stage and Company	*1 Domestic*	*2 International*	*3 Multidomestic*	*4 Global*	*5 Transnational*
Strategy Model	Domestic N.A.	International Co-ordinated Federation	Multidomestic Decentralized Federation	Global Centralized Hub	Global Integrated Network
View of World Markets	Home Country Markets	Extension or Resources	National and Resources	Global Markets	Global Markets
Orientation	Ethnocentric	Ethnocentric	Polycentric	Mixed	Geocentric
Key Assets	Located in Home Country	Core centralized, others dispersed	Decentralized and self-sufficient	All in home country except marketing or sourcing	Dispersed Interdependent and specialized
Role of Country Units	Single Country	Adapting and leveraging competencies	Exploiting local opportunities	Marketing or sourcing	Contributions to company worldwide
Knowledge	Home Country	Created at centre and transferred	Retained within operating units	Marketing developed jointly and shared	All functions developed jointly and shared.

Source : Warren Keegen, *op.cit.*, p. 52.

Units of the transnational corporation in different countries create and develop the knowledge in all functions and share among them. Thus, knowledge and experience are shared jointly. Transnational gains power and competitive advantage by developing and sharing knowledge and experience. Development of dishwashing by using video camera by the French subsidiary of Colgate and sharing of the knowledge among all Colgate operating companies across globle is an example here.

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

(iii) Vision and Aspirations: The vision and aspirations of transnational companies are global, global markets, global customers and grow ahead of other global/transnational companies.

(iv) Geographic Scope: The transnational companies scan the global data and information. By doing so, they analyse the global opportunities regarding the availability of resources, customers, markets, technology, research and development etc. *Similarly,* they also analyse the global challenges and threats like competition from other global companies, local companies of host countries, political uncertainties and the like. They formulate global strategy. Thus, the geographic scope of a transnational company is not limited to certain countries in analysing opportunities, threats and formulating strategies.

(v) Operating Style: Key operations of a transnational are globalised. The transnational companies globalise the functions like R & D, product development, placing key human resources, procurement of high valued material etc. *For example*, the R &D activity of Proctor & Gamble, and key human resource activity of Colgate are the joint and shared activity of the units of these companies in various countries. *(See Table 1.1)*.

(vi) Adaptation: Global and transnational companies adapt their products, marketing strategies and other functional strategies to the environmental factors of the market concerned. *For example*, Mercedes Benz is a superluxury car in North America, luxury automobile in Germany, standard taxi in Europe.

(vii) Extensions: Some products do not require any change when they are marketed in other countries. Their market is just extension. *For example*, Casio calculators of Japan, Hero pens of China, and BlC's line of pens, butane lighters and razors.

(viii) Creation through Extension: Transnational companies create the global brand through extending the product to the new market. Rothmans Cigarettes extended its product to many European countries and African countries and created it as global and national basis.

(ix) Human Resource Management Policy: The transnational company's human resource policy is not restricted by national, political or legal constraints. It selects the best human resources and develops them regardless of nationality, ethnic group etc. But the international company reserves the top and key positions for nationals.

(x) Purchasing: Transnational company procures world-class material from the best source across the globe.

The changing scenarios of international business also resulted in adopting various approaches in doing the business by the multinational companies.Now, we study the approaches to international business.

International business approaches are similar to the stages of internationalisation or globalisation. Douglas Wind and Pelmutter advocated four approaches of international business. They are:

1. Ethnocentric Approach
2. Polycentric Approach
3. Regiocentric Approach
4. Geocentric Approach.

1. Ethnocentric Approach : The domestic companies normally formulate their strategies, their product design and their operations towards the national markets, customers and competitors. But, the excessive production more than the demand for the product, either due to competition or due to changes in customer preferences push the company to export the excessive production to foreign countries. The domestic company continues the exports to the foreign countries and views the foreign markets as an extension to the domestic markets just like a new region. The executives at the head office of the company make the decisions relating to exports and, the marketing personnel of the domestic company monitor the export operations with the help of an export department.

The company exports the same product designed for domestic markets to foreign countries under this approach. Thus, maintenance of domestic approach towards international business is called ethnocentric approach. *Fig. 1.2* makes the ethnocentric concept clearer.

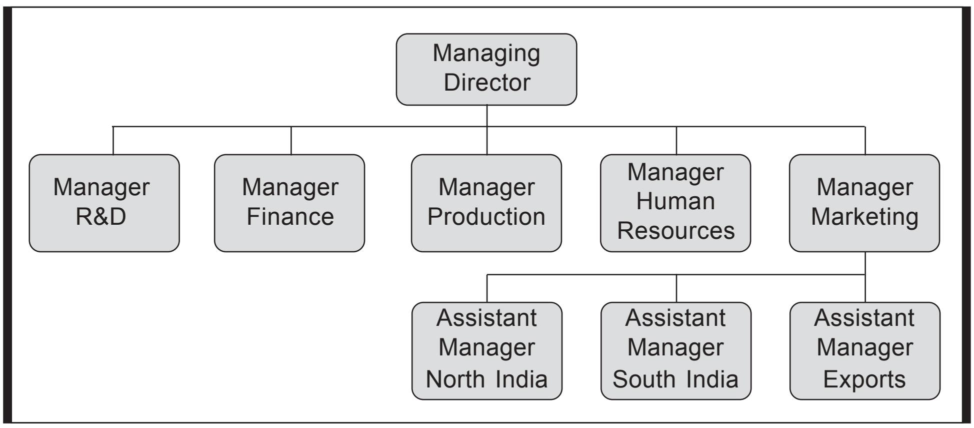

Fig. 1.2 : Organisation Structure of Ethnocentric Company

This approach is suitable to the companies during the early days of internationalisation and also to the smaller companies.

2. Polycentric Approach : The domestic companies which are exporting to foreign countries using the ethnocentric approach find at the latter stage that the foreign markets need an altogether different approach. *(See Fig. 1.3)*.

Then, the company establishes a foreign subsidiary company and decentralises all the operations and delegates decision-making and policy making authority to its executives. In fact, the company appoints executives and personnel including a chief executive who reports directly to the Managing Director of the company. Company appoints the key personnel from the home country and all other vacancies are filled by the people of the host country.

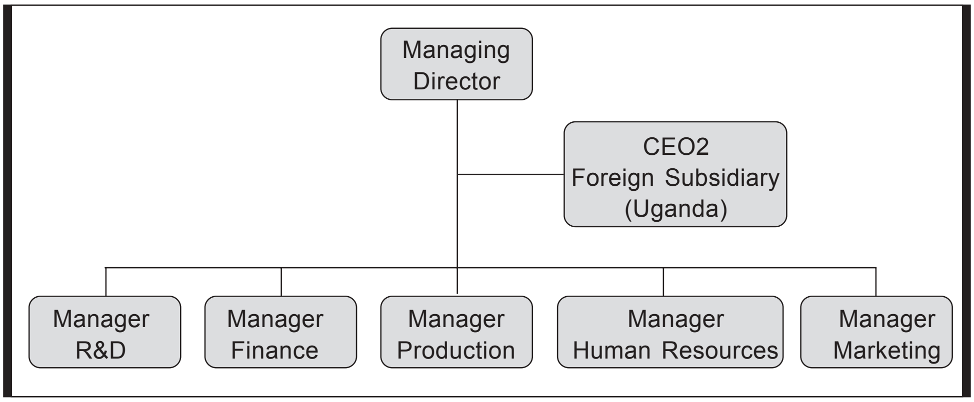

Fig. 1.3 : Organisation Structure of Polycentric Company

The executives of the subsidiary formulate the policies and strategies, design the product based on the host country's environment *(culture, customs, laws, government policies etc.)* and the preferences of the local customers. Thus, the polycentric approach mostly focusses on the conditions of the host country in policy formulation, strategy implementation and operations.

3. Regiocentric Approach

The company after operating successfully in a foreign country, thinks of exporting to the neighbouring countries of the host country. At this stage, the foreign subsidiary considers the regional environment (*for example*, *Asian environment like laws, culture, policies etc.)* for formulating policies and strategies. However, it markets more or less the same product designed under polycentric approach in other countries of the region, but with different market strategies. *(See Fig. 1.4)*.

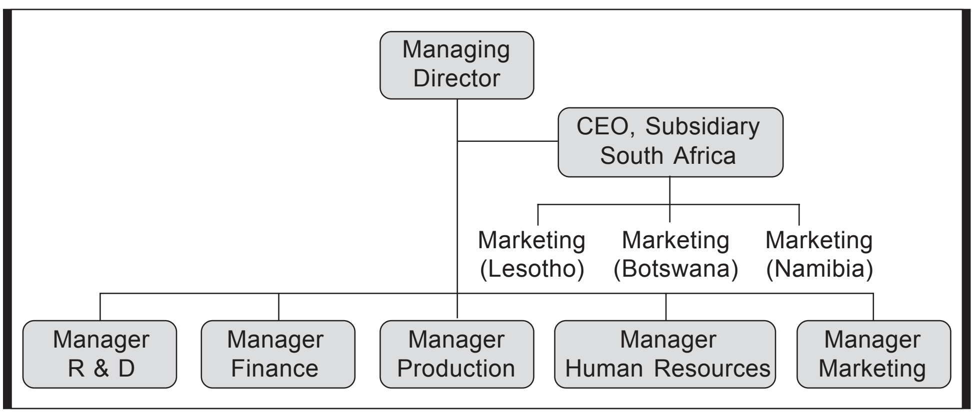

Fig. 1.4 : Organisation Structure of Regiocentric Company

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

Figure 1.5 helps to understand the concept of geocentric approach clearly.

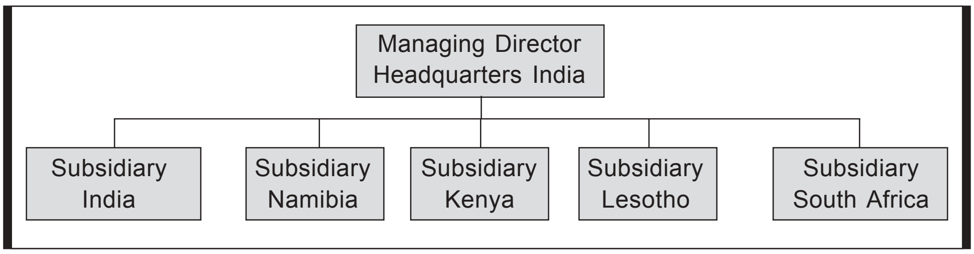

Fig. 1.5 : Organisation Structure of Geocentric Company

Goals of International Business

We have discussed the characteristic features of international business and the precautions that the multinational companies should take while operating in foreign countries. Now, we study the factors affecting international business.

- **To achieve Higher Rate of Profits :** As we have discussed in various courses/subjects like Principles and Practice of Management, Managerial Economics and Financial Management that the basic objective of the business firms is to earn profits. When the domestic markets do not promise a higher rate of profits, business firms search for foreign markets that hold promise for higher rate of profits. Thus the objective of profit affects and motivates the business to expand its operations to foreign countries. *For example,* Hewlett Packard earned 85.4% of its profits from the foreign markets compared to that of domestic markets in 1994. Apple earned US $ 390 million as net profit from the foreign markets and only US $ 310 millions as net profit from its domestic market in 1994.
- **Expanding the Production Capacities beyond the Demand of the Domestic Country :** Some of the domestic companies expanded their production capacities more than the demand for the product in the domestic countries. These companies, in such cases, are forced to sell their excess production in foreign developed countries. Toyota of Japan is an example. *(See Box 1.3 for Economies of Developed Countries).*
- **Severe Competition in the Home Country :** The countries oriented towards market economies since 1960s experienced severe competition from other business firms in the home countries. The weak companies which

could not meet the competition of the strong companies in the domestic country started entering the markets of the developing countries.

BOX 1.3	THE ECONOMIES OF DEVELOPED COUNTRIES
	United States : In the US, the rate of growth of Gross Domestic Product (GDP) rose by 2.6 per cent in the second quarter of 1996 over the corresponding period of 1995 — much higher than the first quarter growth rate of 1.7 per cent. Recent data present a contradictory picture. While some surveys point to a stronger rate of growth of industrial production in the third quarter of 1996, the growth rate of durable goods orders fell by 0.8 per cent between May and June 1996. **Canada :** The Canadian economy's growth rate is likely to pick up in 1996. An index of business confidence shows higher real spending on machinery and equipment in the first half of 1996, reflecting a high level of producer confidence. On the consumption side, however, the picture is less promising. **Japan :** In recent months, the prospects of a sustained recovery in Japan have improved although the Economic Planning Agency has warned that the recovery is still fragile, and that expansionary trends have yet to be confirmed. Recently, there have been increasing signs of an upturn in private consumption, led by improving job opportunities and rising wages. **Australia :** Despite stronger-than-expected economic growth in the first quarter of 1996, the Reserve Bank of Australia (RBOA) lowered the cash rate by 0.5 per cent to 7 per cent in end-July 1996. The governor of the RBOA said that the lower, and declining, rate of growth of wages suggested that economic growth had fallen below its potential levels. Moreover, recent indicators of consumer spending point to a softer private consumption growth rate in the second quarter of 1996 while excess capacity and high inventories suggest that industrial production growth is likely to remain depressed over the next few months.

Source: Adapted from Business Today, August 7-21, 1996, pp. 48-49.

- **Limited Home Market :** When the size of the home market is limited either due to the smaller size of the population or due to lower purchasing power of the people or both, the companies internationalise their operations. *For example,* most of the Japanese automobile and electronic firms entered US, Europe and even African markets due to the smaller size of the home market. ITC entered the European market due to the lower purchasing power of the Indians with regard to high quality cigarettes.

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

- **Political Stability vs Political Instability :** Political stability does not simply mean that continuation of the same party in power, but it does mean that continuation of the same policies of the Government for a quite longer period. It is viewed that USA is a politically stable country. *Similarly,* UK, France, Germany, Italy and Japan are also politically stable countries.

  Most of the African countries and some of the Asian countries are politically instable countries.

  Business firms prefer to enter the politically stable countries and are restrained from locating their business operations in politically instable countries. In fact, business firms shift their operations from politically instable countries into politically stable countries.

- **Availability of Technology and Competent Human Resources :** Availability of advanced technology and competent human resource in some countries act as pulling factors for business firms from the home country. The developed countries due to these reasons attract companies from the developing world. In fact, American and European companies, in recent years, depended on Indian companies for software products and services through their business process outsourcing (BPO). (See *Box 1.4)*

BOX 1.4 INDIAN SOFTWARE INDUSTRY: SOURCES FOR US AND EUROPEAN BUSINESS

Indian government followed protectionist policies since independence. However, the 1990's foreign exchange crisis led to globalization of Indian economy coupled with the information technology revolution. India's education system has been highly successful in producing well qualified engineering, medical and management graduates and scientists. India is currently producing more than 2.5 million graduates a year including around 120,000 IT related programs. India's middle-income group is highly educated in IT related programs, biotechnology, medicine, pharmaceutical and management.

India's top educational institutions are world-class educational institutions. In addition, 50 percent of the India's current population is in the age group of 25-30, which is highly energetic. Added to this, this group of young people is highly endowed with challenging and competitive attitudes. India is the largest English speaking country in the world. The cost of professionals in India is 10 to 15 times less compared to US and European labour markets.

These factors helped Indian software industry to grow at a faster rate with world-class standards. Added to this, satellite communications help Indian business to serve the global business without going globally. As such software firms and other companies around the world depend on India by outsourcing some of their business operations.

India's software exports were US$ 6 billion in 2000. They have grown to a new high an dcould exceed targets set fro the next few years.

- **High Cost of Transportation :** Initially companies enter foreign countries through their marketing operations. At this stage, the companies realise the challenge from the domestic companies. Added to this, the home companies enjoy higher profit margins whereas the foreign firms suffer from lower profit margins. The major factor for this situation is the cost of transportation of the products.

  Under such conditions, the foreign companies are inclined to increase their profit margin by locating their manufacturing facilities in foreign countries where there is enough demand either in one country or in a group of neighbouring countries.

  For example, Mobil which was supplying the petroleum products to Ethiopia, Kenya, Eritrea, Sudan etc., from its refineries in Saudi Arabia, established its refinery facilities in Eritrea in order to reduce the cost of transportation. *Similarly,* Caterpillar located its manufacturing facilities at different centres in order to reduce the cost of transportation. This company produces high-value-added parts in limited locations and less valued and non-critical components and assembles the final products in a number of foreign countries.

- **Nearness to Raw Materials :** The source of highly qualitative raw materials and bulk raw materials is a major factor for attracting the companies from various foreign countries. Most of the US based and European based companies located their manufacturing facilities in Saudi-Arabia, Bahrain, Qatar, Oman, Iran and other middle east countries due to the availability of petroleum. Theses companies, thus, reduced the cost of transportation.

- **Availability of Quality Human Resources at Less Cost :** This is a major factor, in recent times, for software, high technology and telecommunication companies to locate their operations in India. India is a major source for high quality and low cost human resources unlike USA, developed European countries and Japan. Importing human resources from India by these firms is costly rather than locating their operations in India. Hence, these companies started their operations in India, China and Thailand.

- **Liberalisation and Globalisation :** Most of the countries in the globe liberalised their economies and opened their countries to the rest of the globe. These changed policies attracted the multinational companies to extend their operations to these countries.

- **To Increase Market Share :** Some of the large-scale business firms would like to enhance their market share in the global market by expanding and intensifying their operations in various foreign countries. Companies that expand internally tend to be 'oligopolistic'. Smaller companies expand internationally for survival while the larger companies expand to increase the market share. *For example,* Ball Corporation, the third largest beverage cans manufacturer in USA, bought the European packaging operations of Continental Can Company. Then it expanded its operations to Europe and met the Europe demand which is 200 per cent more than that of USA. Thus, it increased its global market share of soft drink cans.

- **To Achieve Higher Rate of Economic Development :** International business helps the governments to achieve higher growth rate of the economy, increase the total and per capita GDP, industrial growth, employment and income levels. (See *Box 1.5)*

BOX 1.5 INTERNATIONAL BUSINESS : CONTRAST IN ECONOMIC DEVELOPMENT OF SOUTH KOREA AND GHANA

Ghana attained independence from U.K. in 1957 and adopted Socialism Government established state owned enterprises including Cocoa Marketing Board. Ghana followed a policy of self dependency policy. Ghana had the natural advantage in producing Coca and it is the world's largest exports of Cocoa before 1957. The Cocoa Marketing Board used to purchase Cocoa from formers at price almost equal to 50% of world's price and at sell in the global market. Farmers switched over to food crops due to less price offered by the Cocoa Marketing Board. Consequently, the country's exports and foreign exchange reserves declined by 1980s. Country faced with recession since 1990s. As such the annual per capita income increased from US $ 250 1970 to only US $ 390 in 1998.

In contrast, South Korea whose annual per capita income was more or less equal to that of Ghana in 1970 *i.e.,* US $ 260. Significantly increased to US $ 8,600 in 1998. The reasons for this miracle development of South Korea include: following free trade policies, reduction in tariffs and quotas, reduction in export subsidies, developing the educational facilities, shift of the economy from agriculture sector to industrial sector, shift from labour intensive industry to capital intensive industry, creation of competition among business and encouraging the business to export.

Thus the closed economic policy of Ghana led it to a poor country and opened economic policy of South Korea led it to a fast advanced country.

Source : Adapted from *"Poor Man's Burden"* A Survey of the Third World, September 23, 1989, World Bank, World Development Report, 2000, Oxford University Press 2000 and Charles W.L. Hill, *"International Business"*, Tata Mc Graw-Hill, New Delhi, 2003, pp. 137-138.

- **Tariffs and Import Quotas :** It was quite common before globalisation that governments imposed tariffs or duty on imports to protect the domestic company. Sometimes Government also fixes import quotas in order to reduce the competition to the domestic companies from the competent foreign companies. These practices are prevalent not only in developing countries but also in advanced countries.

For example, Japanese companies are tough competitors to the US companies. USA imposed tariffs and quotas for import of automobiles and electronics from Japan. Harley-Davidson of USA sought and got five years of tariffs protection from Japanese imports. *Similarly,* Japan places high tariffs on imports of rice and other agricultural goods from the USA.

To avoid high tariffs and quotas, companies prefer direct investment to go globally. *For example,* companies like SONY, Honda and Toyota preferred direct investment in various countries by establishing subsidiaries or through joint ventures in various foreign countries including the USA and India. *Similarly,* General Electricals and Whirlpool also have foreign subsidiaries. Xerox, Canon, Philips, Unilever, Lucky Gold Star, South Korean Electronics Company, Pepsi, Coca-Cola, Shell, Mobil etc. established manufacturing facilities in various foreign countries in order to avoid tariffs, import duties and quotas.

Having discussed the need for international business, we shall discuss the stages of international business.

(E) ADVANTAGES OF INTERNATIONAL BUSINESS

So far, we have discussed the basis for international business by studying the theories. You might have observed the competitive advantages which are derived from this analysis. *For example,* the comparative cost theory concludes that the countries can specialise in producing certain products in which they have the competitive advantage of producing at low cost. It does mean that the customers in all the countries can have the goods at low price. Now, shall we discuss the competitive advantages of international business:

- **High Living Standards :** Comparative cost theory indicates that the countries which have the advantage of raw materials, human resources, natural resources and climatic conditions in producing particular goods can produce the products at low cost and also of high quality. Customers in various countries can buy more products with the same amount of money. In turn, it can also enhance the living standards of the people through enhanced purchasing power and by consuming high quality products.
- **Increased Socio-Economic Welfare :** International business enhances consumption level, and economic welfare of the people of the trading countries. *For example,* the people of China are now enjoying a variety of products of various countries than before as China has been actively involved in international business like Coca-Cola, McDonald's range of products, electronic products of Japan and coffee from Brazil. Thus, the Chinese consumption levels and socio-economic welfare are enhanced.

- **Wider Market :** International business widens the market and increases the market size. Therefore, the companies need not depend on the demand for the product in a single country or customer's tastes and preferences of a single country. Due to the enhanced market the Air France, now, mostly depends on the demand for air travel of the customers from countries other than France. This is true in case of most of the MNCs like Toyota, Honda, Xerox and Coca-Cola.
- **Reduced Effects of Business Cycles :** The stages of business cycles vary from country to country. Therefore, MNCs shift from the country, experiencing a recession to the country experiencing 'boom' conditions. Thus, international business firms can escape from the recessionary conditions.
- **Reduced Risks :** Both commercial and political risks are reduced for the companies engaged in international business due to spread in different countries. Multinationals which were operating in erstwhile USSR were affected only partly due to their safer operations in other countries. But the domestic companies of then USSR collapsed completely.
- **Large-Scale Economies :** Multinational companies due to the wider and larger markets produce larger quantities, which provide the benefit of large-scale economies like reduced cost of production, availability of expertise, quality etc.
- **Potential Untapped Markets :** International business provides the chance of exploring and exploiting the potential markets which are untapped so far. These markets provide the opportunity of selling the product at a higher price than in domestic markets. *For example,* Bata sells shoes in the UK at £ 100 (Rs. 7,000) whose price is around Rs. 700 in India.
- **Provides the Opportunity for and Challenge to Domestic Business :** International business firms provide the opportunities to the domestic companies. These opportunities include technology, management expertise, market intelligence, product developments etc. *For example,* Japanese firms operating in the US provide these opportunities to the US companies. This is more evident in the case of developing countries like India, African countries and Asian countries.

  Similarly, the MNCs pose challenges to the domestic business initially. Domestic firms develop themselves to meet these challenges. Thus, the opportunities and challenges help the domestic companies to develop. Maruti helped Telco to come up with Tata Indica. Foreign Universities helped IIMs, IITs and Indian Universities to enhance their curricula.
- **Division of Labour and Specialisation :** As mentioned earlier, international business leads to division of labour and specialisation. Brazil specialises in coffee, Kenya in tea, Japan in automobiles and electronics, India in textile garments etc.

- **Economic Growth of the World :** Specialisation, division of labour, enhancement of productivity, posing challenges, development to meet them, innovations and creations to meet the competition lead to overall economic growth of the world nations. International business particularly helped the Asian countries like Japan, Taiwan, Korea, Philippines, Singapore, Malaysia, and the United Arab Emirates.
- **Optimum and Proper Utilisation of World Resources :** International business provides for the flow of raw materials, natural resources and human resources from the counties where they are in excess supply to those countries which are in short supply or need most. *For example,* flow of human resources from India, consumer goods from the UK, France, Italy and Germany to developing countries. This, in turn, helps in the optimum and proper utilisation of world resources.
- **Cultural Transformation :** International business benefits are not purely economical or commercial, they are even social and cultural. These days, we observe that the West is slowly tending towards the East and *vice versa*. It does mean that the good cultural factors and values of the East are acquired by the West and *vice versa*. Thus, there is a close cultural transformation and integration.
- **Knitting the World into a Closely Interactive Traditional Village :** International business, ultimately knits the global economies, societies and countries into a closely interactive and traditional village where one is for all and all are for one.

Competitive advantage in a Global Setting

According to Pitts and Snow, competitive advantage is, “any feature of a business firm that enables it to earn a higher return on investment, despite counter pressure from competitors.” They view that competitive advantage is gained at the corporate level through synergy and strategic business unit level through market share. Large size of the business firms can grow further by entering into new markets of various countries. Large firms have the following advantages:

- Large-scale economies like low cost of production, effective utilisation of resources, appointment of specialists and experts etc.
- Ability to expand and diversify its activities.
- Ability to bear political and commercial risks.
- Paying less rate of interest to its creditors and underwriters.
- Ability to bargain with the suppliers of inputs and achieve the agreement at favourable terms for the company.
- Providing customer services efficiently and economically.
- Paying less taxes to the Government by shifting the funds from one business to another.

- Use portfolio planning to have synergistic advantage by allocating more resources to those portfolios/products which have high market demand and by reducing the resources to those products/portfolios with low market demand. In other words, the company reduces or stops further investment in dogs, diverts the income from cash cows to problem children and/or star portfolios.

Further, business firms can get the competitive advantage from the following sources:

- **Economies of Scale:** Companies can get the economies of scale through division of labour, specialisation, automation, rationalisation, computerisation, forward integration and backward integration.
- **Latest Technology:** Companies can adopt the latest technology either on their own and/or through joint-ventures.
- **Human Resources:** Highly committed, skilled, and innovative human resources, employees with positive attitude and high emotional quotient would also enhance the competitive advantage to the company.
- Continuous upgradation of employees through learning and training.
- Computer-Aided design, production process, e-commerce, business process re-engineering and enterprise resource planning would also be sources for competitive advantage.
- Product and process innovation and development.
- Employees with diversified culture and cultural collaboration.
- Continuous organisational learning, capacity building and upgradation.
- Acquiring market power to understand, monitor and control suppliers of inputs, customers, dealers or market intermediaries and competitors.
- Cheap sources of raw materials, finance etc., in various foreign countries.
- Changing and varying tastes and preferences of customers at varying degrees across the globe.
- Different levels of economic development, social and cultural development, technological development of world countries.
- Mobility of labour force across the globe.

(F) PROBLEMS OF INTERNATIONAL BUSINESS

As is said that, *"life is not a bed of roses"*, international business is not all that lovely. It has its problems. The important problems include:

- **Political Factors:** Political instability is the major factor that discourages the spread of international business. *For example, in* the Iran-Iraq war, Iraq-Kuwait war, dismantling of erstwhile USSR, Civil War in Fiji, Malaysia, and Sri Lanka, military coups in Pakistan, Afghanistan, frequent changes in political parties in power and thereby changes in government policies in India etc., created political risks for the growth of international business. Also, latest Indo-Pak Summit at Agra in July, 2001 ended in a no compromise situation, which affected international business. However, the business people from India and Pakistan are planning to develop trade links between the countries (*See Box 1.6*).

BOX 1.6 INDO-PAK CEO'S FORUM FOR ENHANCING TIES

A day after its launch, the India-Pakistan CEO's Forum on 15th September 2003, said it has identified trade and investment, manufacturing, services and communications as the four key initiative areas for enhancing trade between the two countries. "The CEO forum is an institution-building exercise by the thought leaders of the two countries. The forum is involved in building a more positive trade scenario in the region and will act as a base camp to improve relations between the two neighbours," Confederation of Indian Industry (CII) president Anand Mahindra said.

He said the Forum aimed at building a congenial atmosphere to exploit the trade potential between the two countries. Amin Hashwani, leader of visiting Pakistan delegation and the co-chairperson of the forum emphasized the need to restore rail and air links between India and Pakistan.

Source: News Times, 17th September 2003

- **Huge Foreign Indebtedness:** The developing countries with less purchasing power are lured into a debt trap due to the operations of MNCs in these countries. *For example,* Mexico, Brazil, Poland, Romania, Kenya, Congo, and Indonesia.
- **Exchange Instability:** Currencies of countries are depreciated due to imbalances in the balance of payments, political instability and foreign indebtedness. This, in turn, leads to instability in the exchange rates of domestic currencies in terms of foreign currencies. *For example,* Zambia, India, Pakistan, Philippines depreciated their currencies many times. This factor discourages the growth of international business *(See Box 1.7).*
- **Entry Requirements:** Domestic governments impose entry requirements to multinationals. *For example,* an MNC can enter Eritrea only through a joint-venture with a domestic company. However, with the establishment of World Trade Organisation (WTO), many entry requirements by the host governments are dispensed with.
- **Tariffs, Quotas and Trade Barriers :** Governments of various countries impose tariffs, import and export quotas and trade barriers in order to protect domestic business. Further, these barriers are imposed based on the political

and diplomatic relations between or among Governments. *For example,* China, Pakistan and USA (before 1998) imposed tariffs, quotas and barriers on imports from India. But the erstwhile USSR and present Russia liberalised imports from India.

BOX 1.7 **IMPACT OF ASIAN CRISIS ON GLOBAL BUSINESS**

Almost everyone, particularly those living in Asia, knows that the year 1998 was bad, economically speaking. And now you can put a statistical handle into that feeling of infirmity. The economic contraction in much of Asia slowed the growth rate of world trade to 3.5 per cent in 1998, a steep climbdown from the unusually strong rate of 10.5 per cent in 1997, says the World Trade Organisation (WTO).

Figures just released by the WTO help to place in perspective this 3.5 per cent growth rate of the volume of world merchandise exports. In contrast, the average growth rate for the period 1990-95 was 6 per cent, while the dollar value of world merchandise trade declined by 2 per cent in 1998, the strongest decrease since 1982.

According to the WTO, trade contraction in Asia has been the single biggest factor on the global trade slowdown. Of all the regions, Asia recorded the strongest import contraction, both in volume and value terms. Import volumes shrunk by around 8.5 per cent, mainly due to the 5.5 per cent contraction experienced by Japan and the over 20 per cent recorded by crisis-ridden Indonesia, Malaysia, Philippines, Korea and Thailand.

The main reason for the sharp import contraction, says the WTO, was the turnaround in private capital flows and the associated drop in domestic investment and consumption levels. Only a few countries in the region, like India, Sri Lanka, China, and Australia, bucked the trend to post an increase in import volumes. But that did little to boost the region's overall trade growth. Since intra-Asian trade accounts for around half of Asia's merchandise exports, the import contraction pulled back the growth rate of exports too.

Even though several Asian countries devalued their currencies to boost the price-competitiveness of their enterprises, they could not make much headway in the market of the developed world. In fact, 1998 China's exports to the US, Japan and Europe grew faster than those of the five Asian countries worst hit by the financial crisis.

Source: Adapted from K.G. Kumar, *Business Today,* May 17-30, 1999, pp. 43-44.

- **Corruption :** Corruption has become an international phenomenon. The higher rate bribes and kickbacks discourage the foreign investors to expand their operations.
- **Bureaucratic Practices of Government :** Bureaucratic attitudes and practices of Government delay sanctions, granting permission and licences to foreign companies. The best example is Indian Government before 1991. Such practices make the MNCs to enter other countries.
- **Technological Pirating :** Copying the original technology, producing imitative products, imitating other areas of business operations were

common in Japan during 1950s and 1960s, in Korea, India etc. This practice invariably alarms the foreign companies against expansion.

- **Quality Maintenance**: International business firms have to meticulously maintain quality of the product based on quality norms of each country. The firms have to face server consequences, if , they fail to confirm the country standards. Consumers' forums / associations also inspect quality in addition to the government machinery in various foreign countries. *(See Box 1.8)*

BOX 1.8 TINNED FISH WARNING

The Independent Consumers and Competition Commission (ICCC) acting commissioner Thomas Abe issued the warning after the commission received several reports and complaints from consumers who had found foreign objects in the 777 brand of mackerel tinned fish. The commission suspects wrongful packaging of sardines in the standard mackerel cans in the imported product. Mr. Abe said the commission had kept a record of complaints where sardines were packed in 425-gram mackerel cans, and where worms or maggots were found in some of the 425g of 777 mackerel cans in tomato sauce. ICCC had conducted investigations and was told by the manufacturer that because of the shortage in the supply of mackerel from Mexico, the manufacturer had used mackerel from other regions like China, which were smaller in size than the normal mackerel. The commission also carried out investigations into worms found in some cans by collecting 20 cans of 777 mackerel — both in tomato and oil from various supply outlets in the National Capital District. The tins showed no evidence of bacteria after tests were carried out at the Port Moresby General Hospital's Central Public Health Laboratory (CPHL). The commission was advised by the laboratory that the worms found in the cans were actually round worms known as nematode, which are present in marine fish such as mackerel, and were no harm to humans as they were cooked in their larval stages. Investigations are, however, continuing in regard to the report on January 17, about maggots found in a 425g can of mackerel. Mr. Abe said the commission had written to the supplier concerned to recall the batches that were ordered together with the cans that allegedly contained worms and maggots. Consumers have been warned to check for expiry dates and to alert the commission about the sales of expired goods.

Source : Adapted from http://www.postcourier.com.pg/20050124/mohome.htm-24th Jan.2005)

- **High Cost :** Internationalising the domestic business involves market survey, product improvement, quality upgradation, managerial efficiency and the like. These activities need larger investments and involve higher cost and risk. Hence, most of the business houses refrain themselves from internationalising their business.

CONCLUSION

However, the benefits of international business outweigh the problems. Added to this, globalisation is the order of the day. Most of the countries eliminated the barriers and paved the way for the growth and expansion of international business. In fact, international business, during the third millennium (2001 and beyond) is just an extension to inter-regional business within a country.

POINTS TO BE REMEMBERED

- International business is evolved from international trade and international marketing.
- International business is a crucial venture due to the influence of varied social, cultural, political, economic, natural factors, and government policies and laws.
- Business firms go globally to maximise benefits and minimise risks.
- The five stages of internationalisation are domestic company, international company, multinational company, global company and transnational company.
- International business approaches include ethnocentric approach, polycentric approach, regiocentric approach and geocentric approach.
- The advantages of international business include: wider markets, high living standards, optimum utilisation of resources etc.
- Problems of international business include: political factors, foreign exchange, tariffs, cost etc.
- The firms get the competitive advantages like economies of scale, latest technology, expert human resources, etc., by going global.

KEY WORDS

- International Trade
- International Marketing
- International Business
- Host Country
- Wider Market
- Cultural Transformation
- Entry Requirements
- Globalisation
- Quotas
- Tariffs
- Comparative Cost
- Opportunity Cost
- Competitive Advantage
- Exchange Stability

QUESTIONS FOR DISCUSSION

1. How is international business broader in scope compared to international trade and international market?
2. Explain the nature of international business.
3. Why is international business a crucial venture?
4. Why do business firms of a country go to other countries? Give your answer with

suitable examples.

5. Explain stages of internationalisation.
6. State the different approaches to international business.
7. What are the competitive advantages of international business?
8. Why is international business not a bed of roses? Elucidate your answer with suitable examples.

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9. According to BCG Matrix Dogs is a position of a firm when industry growth rate and market share of the firm are at low level.
10. According to BCG Matrix, cash cows is a position of a firm when the market share of the firm is high and industry growth rate is low.

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Unit Two

INTERNATIONAL BUSINESS ENVIRONMENT

CHAPTER OUTLINE

(A) INTRODUCTION

We have studied the introduction to international business in the first chapter. Now, we shift our focus from macro aspects to micro aspects of international business. A global company has to formulate strategies based on its missions, objectives and goals. Strategy formulation is a must for a global company to make decisions regarding the markets to enter, product/service range to introduce in the foreign countries and the like. Further, the severe and intensified competition in the global market makes the strategy formulation a challenging task.

The fundamental basis for strategy formulation is the environmental analysis. Environment provides the opportunities to the business to produce and sell a particular product. *For example,* the present day business environment provides wide opportunity for Internet. *Similarly,* environment in India provides opportunity for production and selling of fuel saving motor bicycles. European climatic condition provides an opportunity for woollen and leather garments.

Environment, sometimes poses threats and challenges to business. Business should enhance its strengths in order to face the challenges posed by the environment. *For example,* China dumped steel at cheap prices in the Indian market and posed a threat to the Indian steel industry i.e. Consequently, Indian steel industry improved its technology in order to meet the challenges and dumped its steel in US markets.

Study of environment helps the business to formulate strategies and run the business efficiently in the competitive global market. We understand that environment has significant and crucial impact on the business. Thus, business depends on environmental dynamics. Now, we study the meaning of business environment.

Meaning of international Business Environment

Environment means surrounding. International business environment means the factors/activities those surround/encircle the international business. In other words, business environment means the factors that affect or influence the MNCs and transactional companies.

Factors that affect International Business include Social and Cultural factors (S), Technological factors (T), Economic factors (E), Political/Governmental factors (P), International factors (I) and Natural factors (N). (STEPIN)

William F. Glueck defined the term environmental analysis as, "the process by which strategists monitor the economic, governmental / legal, market/competitive, supplier / technological, geographic and social settings to determine opportunities and threats to their firms."

"Environmental diagnosis consists of managerial decisions made by analysing the significance of data (opportunities and threats) of the environmental analysis."

international Business Environmental Factors

Business environmental factors are broadly divided into internal environmental factors and external environmental factors *(Fig. 2.1)*. Internal environmental factors influence/affect the business from within. They include: human resource management, trade unions, organisation structure, financial management, marketing management and production management, management/leadership style etc.

External environmental factors are further divided into micro external factors and macro external environmental factors. Micro external environmental factors include: competitors, customers, market intermediaries, suppliers of raw materials, bankers and other suppliers of finance, shareholders, and other stakeholders of the business firm.

External macro environmental factors include: social and cultural factors, technological factors, economic factors, political and governmental factors, international factors and natural factors. Environmental protection received greater attention in order to protect the lives of the people, animals, plants and to maintain ecological balance *(See Box 2.1 and Box 2.2)*. The analysis of internal environmental factors indicates the strengths and weaknesses of the business firm while the analysis of micro external and macro external environmental factors indicate the opportunities provided by the environment to the business. The strengths, weaknesses, opportunities and threats (SWOT) analysis helps to formulate strategies for the business firm.

Now, we shall discuss the macro external environmental factors. We start our discussion with the social and cultural environmental factors.

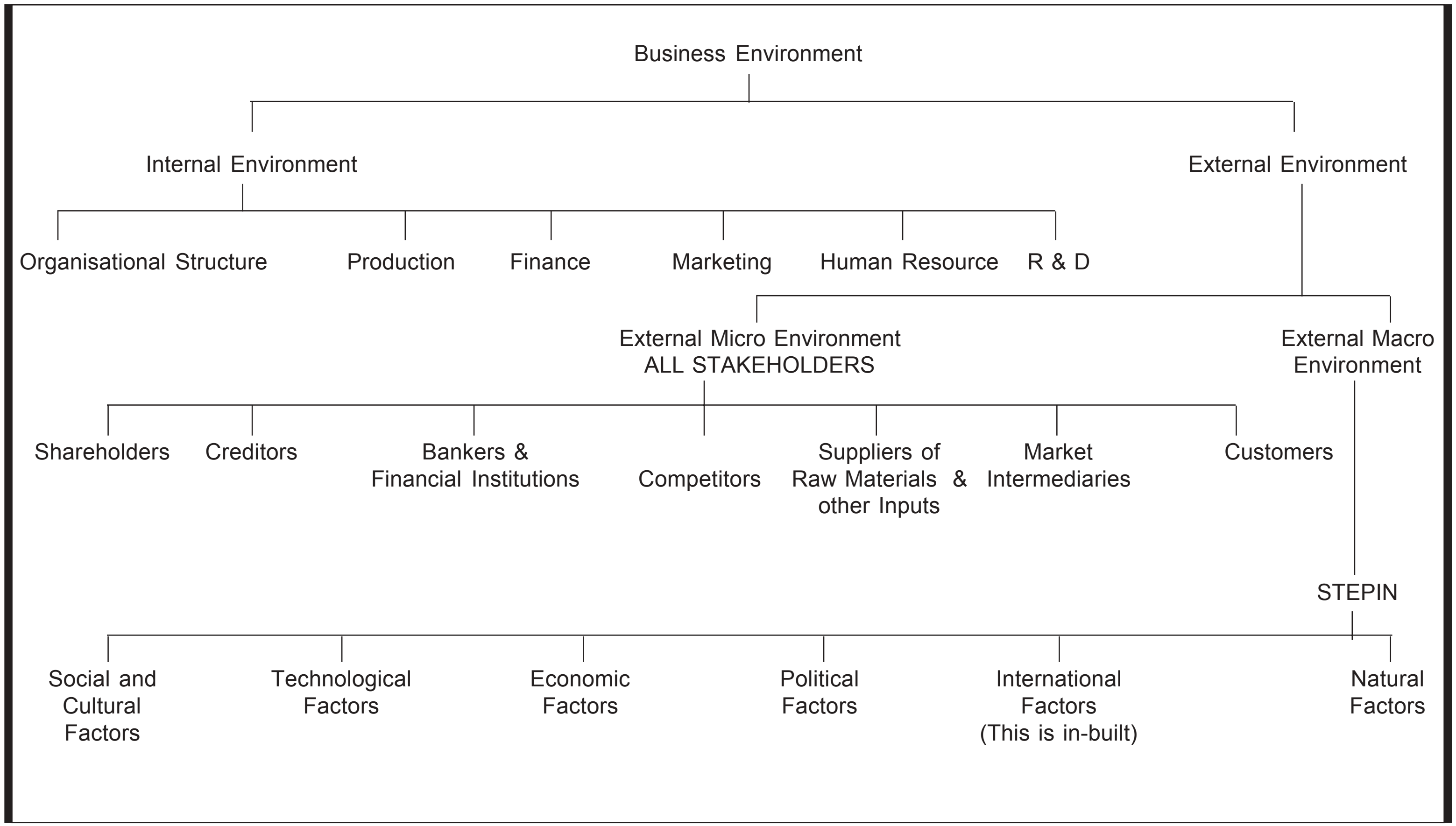

Fig. 2.1 : Business Environment

BOX 2.1 : ENVIRONMENTAL PROTECTION BY LIHIR GOLD LIMITED, PAPUA NEW GUINEA

An Environment Section has been established by Lihir Gold Limited, Papua New Guinea to ensure that operations comply with permits and licences, and have minimal impact on the surrounding environment. A comprehensive, government-approved Environmental Management and Monitoring Program (EMMP) details all environmental monitoring and reporting to be undertaken. Using world-class monitoring systems 15 highly-trained environment personnel monitor 21 elements at more than 50 locations - from air, water and soil quality, to noise levels and the health of fish, coral, seagrass, sago trees and megapodes (a local scrub fowl).

The company's extensive monitoring is critically examined through validation sampling by external auditors and scientists from the PNG Office of Environment and Conservation. Independent audit reports show that Lihir's mining operations comply with licence conditions and that the level of impacts originating from the mine's operational activities continue to be less than originally predicted. The company invested US$ 33 million during 2002 and 2007 for environmental protection.

Source: Lihir Gold Limited, Papua New Guinea

BOX 2.2 : SCAND IN AVIAN MARKETS AND ENVIRONMENTAL PROTECTION

In Scandinavian markets there are very strict environmental protection standards, and both a power-tool maker and a detergent manufacturer have had to make technical adjustments to their standard products to gain market acceptance: these adjustments are not related to the technical performance of the products but concerned with their impact on the environment. The tool manufacturer was required to reduce the noise level of his tools and to change the sound frequency on which they operated, the detergent manufacturer had to introduce a new formula which substantially reduced lather and sudsing in the washing process to eliminate water pollution.

Source: Edgar P. Hibbert, *"International Business",* p. 65

(B) SOCIAL AND CULTURAL ENVIRONMENT

Social and cultural factors in various countries of the globe affect the international business. These factors include attitude of the people to work, attitude to wealth, family, marriage, religion, education, ethics, human relations, social responsibilities etc.

Culture is, "the thought and behaviour patterns that member of a society learns through language and other forms of symbolic interaction — their customs, habits, beliefs and values, the common view points which bind them together as a social entity.... Cultures change gradually picking up new ideas and dropping old ones, but many of the cultures of the past have been so persistent and self contained that the impact of such sudden change has torn them apart, uprooting their people psychologically." Characteristics of culture are:

Culture is:

- derived mostly from the climatic conditions of the geographical region and economic conditions of the country.
- a set of traditional beliefs and values which are transmitted and shared in a given society.
- a total way of life and thinking patterns that are passed from generation to generation.
- norms, customs, art, values etc.
- **Prescriptive:** It prescribes the kinds of behaviour considered acceptable in the society. It limits product choices to those which are socially acceptable. *For example,* consumption of alcoholic drinks is acceptable in the West, but it is not socially acceptable in India and it is socially and legally unacceptable in Saudi Arabia *(See Box 2.3)*. *Similarly,* smoking is medically unacceptable even in the USA — in the recent times.

BOX 2.3 PROHIBITION OF ALCOHOL AT DIFFERENT DEGREES IN DIFFERENT COUNTRIES

Many *Muslim* countries, such as *Saudi Arabia*, prohibit alcohol for religious reasons. Drinking alcohol in public places, such as streets and parks, is against the law in most of the United States and in some European countries. But is legal in others such as *Belgium* and *Germany.* In *The Netherlands* it is not specifically illegal by law, but many cities and towns prohibit having an open container.

- **Socially Shared:** Culture is based on social interaction and creation. In fact, it is out of necessity. *For example,* child marriages in India during the 18th and 19th centuries were meant to protect the teenaged girls. Chinese parents, at one time preferred their female children to have small feet. The practice of the Sikhs wearing turbans and keeping a knife was originally out of the necessity of protecting themselves from the invaders from other countries.
- **Learned:** Culture is acquired through learning but not inherited genetically. If a person absorbs or learns the culture of the society where he is raised, that learning is called socialization or enculturation. However, some people learn the culture of the society other than the one in which they are raised. Such learning is called 'acculturation.' *The societies of Asian and African countries complain that their cultures are being contaminated by the Western influences.*
- **Subjective:** Culture is subjective in the sense that people of different cultures have different ideas about the same object. Regarding the object of marriage

the parents of the bridegrooms in many countries offer money (dowry) to the parents of the bride whereas the situation in India is quite opposite. This is because, the parents of bridegrooms in other countries pay dowry as a compensation for raising the bride while the parents of bride in India pay dowry to the bridegroom to meet the expenses of establishing a new family. Japanese human resource management culture is based on employee loyalty to the organization and life-time employment *(See Box 2.4)*.

- **Cumulative:** Uncertainty of rains, crop and thereby income in developing countries over the years resulted in the culture of saving for to the next year. Thus, culture is based on the accumulated circumstances over the hundreds or even thousands of years.
- **Dynamic:** Culture is not immune to change. It goes on changing. New ideas are added and old ideas are dropped. The present generation youth want to become slim. Therefore, they reduced fat contents in all the food items unlike the previous generations. Further, the present generation youth would like to work smart but not hard unlike their parents. Japanese tastes have been changing from rice and fish to meat and dairy products.

Indian housewife never allowed her family members to eat in hotels/restaurants 25 years back. But the present day housewife prefers to eat outside alongwith the entire family at least once in a week.

BOX 2.4 LIFETIME EMPLOYMENT IN JAPAN

Life-time employment or permanent employment, has been the rule in big Japanese companies beginning with the first economic successes in the *1920s*. It gives Japanese workers the important feeling of job security as part of *Japanese management culture*, and in turn, elicits a high degree of company loyalty.

A high demand for the few available engineers forced companies to bind these employees to the company. The collapse of the *Japanese asset price bubble* and the following crisis in the *1990s* did not weaken the practice. It is also used in small Japanese companies. In 2003, 83% of major Tokyo firms still had policies of lifetime employment. The practice has been strengthened in the past years as the economic situation has significantly improved.

Employees in Japan are also loyal to the companies and they don't normally change the employers. Japan obviously relies extensively on its human capital to fulfill its national economic objectives. The "Look East Policy" was developed to emulate Japanese style of management, especially human resource management. Japanese human resource management places great emphasis on the internal labor market to fill promotion opportunities, long-term development programs and job security, among others. All these are contributory factors for employee loyalty.

Cultural Attitude and International Business

Dressing habits, living styles, eating habits and other consumption patterns, priority of needs are dictated/influenced by culture. Some Chinese and most of the Indians do not consume beef. Thailand Chinese believe that consumption of beef is improper and Indians (particularly Hindus) believe that eating beef is a sin as they believe cow is sacred (*Kamadhenuvu*).

The eating habits vary widely. Chinese eat fish stomachs, and bird's nest soup, Japanese eat uncooked sea food, Iraqis eat dried, salted locusts and snakes while drinking. The French eat snails, Americans and Europeans eat mostly non-vegetarian food. Indians eat mostly vegetarian food. It was surprising to the rest of the world to know that there were pure vegetarians in India.

However, the foreign culture regarding food has been adapted, *Masala dosa* and *Hyderabadi Biryani* have become popular in Europe and the USA whereas Pizzas have become popular in India (*See Box 2.5*).

BOX 2.5 **IN INDIA, PIZZAS ARE NOW THE FLAVOUR OF THE SEASON**

Chicken tikka masala may be ruling the roost in Britain, but in curry country – India – pizzas are the flavour of the month. Take, for example, Neelam Mehta. Whenever she hears the question "What's for dinner, mum?" after she comes home from her Delhi office, her answer is often the same : "Pizza". "It's the easiest thing to do. Just pick-up the phone and order. I don't have to sweat it out in the kitchen at the end of the day," said Mehta, an Indian exporter with two teenage sons. Ever since India threw open its economic doors in the early 1990s, a host of global pizza chains including Pizza Hut, run by Yum! Brands Inc, Pizza Hot, Domino's Pizza and many more have been fighting for a slice of the country's growing pizza market.

Source: Deccan Chronicle, July 22, 2003,

Similarly, dressing habits also vary from country to country based on their culture. We observe different dress styles of the West, Middle East, India, Pacific etc. Wearing 'saree' by Indian women is influenced by the culture. *Similarly*, wearing 'burka/ parda' by the women of the Middle East is another example for the influence of culture on the dressing habit.

The international businessmen should eliminate the social, religion and cultural effect in order to understand the foreign cultures as they have to carry on business under the existing cultures. Most of the businessmen of the USA react to the methods in ethnocentric terms and prefer to conduct business on Western lines though they know the cultures of Asia and Africa. The businessman should eliminate the influence of social, religion and cultural as it helps to prevent a transfer of personal culture to the overseas market. This awareness helps the manager to formulate customer-oriented strategies and avoid the possible failures. *(See Box 2.6).*

Guidelines for the businessman when they launch business in foreign countries: *(a)* resist the tendency to conduct business immediately on landing, and at all times, *(b)* offer favours as a business tool to generate allies, *(c)* contact, cultivate and conduct field work among at least one sample clientele to serve as an initial testing centre for the firm's product, *(d)* introduce the product line into the sample group by local firms of cause-related marketing and *(e)* extend product acceptance beyond the sample clientele into related market segments. Businessmen should follow these guidelines in order to prevent possible failures *(See Box 2.7)*.

BOX 2.6 **INDIANIZING ALL THE MCDONALD'S WAY**

In the mid 1990s, a spate of global fast food chains entered India hoping to capture a part of Indian fast food segment. But they found it difficult to establish themselves. Gaining acceptance locally and blending into the Indian culture proved difficult.

By 1994, some international suppliers of McDonald's had visited India to identify local partners. Meetings with agriculturists were conducted with a view to set up a supply chain. Finally, all this fructified when a 50:50 joint venture was entered between McDonald's and Hardcastle Restaurants Pvt. Ltd.

To gain acceptance locally, McDonald's had to modify its menu – substituting mutton for beef in the burgers, (something it had never done in any other market), choosing names like McAloo and Maharaja Mac, and introducing variations and dishes that were not available at any McDonald's outlet anywhere in the world.

From the meticulous sourcing of raw materials and the elimination of beef and pork from its 'desi' menus to even segregating the vegetarian and non-vegetarian workers, McDonald's seemed to be extremely orthodox in its approach. India was the first country to use the complete vegetable burger, creating the eggless mayonnaise vegetable burger, so was the case with 'mutton' burgers.

BOX 2.7 **DISNEY IN FRANCE: CULTURAL ISSUES**

Disney with its success in park business and entertaining children in USA entered Japan in 1983 and became successful there too. Disney decided to enter Paris and France market too in 1986 owing to locational advantage of Paris and availability of subsidies and incentives by French Government. Disney had problems of negotiations with France Government and also unwillingness of French people to accept Disney. Despite these problems, Disney opened the park in 1992 summer. Soon after the opening, French farmers drove their tractors and blocked the entrance. Later, there were a number of operational deviations like Disney's policy of serving no alcohol, serving less quantity of breakfast, lunch timings, non-suitability of teamwork for the employees of Disney of Paris. These problems resulted in a cumulative loss of $2 billion by the end of 1994.

Source: Adopted from Charles W.L. Hill, *International Business:* New Delhi, 2003, pp.119-12.

Cross-Cultural Communication Process and Negotiations

In some countries like the USA, Canada, Germany and Switzerland the messages that the people convey are explicit and clear. They use the actual words to convey the information. These cultures are called 'low-context cultures'.

In countries like India, Japan, Saudi Arabia, and other middle eastern Arab countries, communication is mostly indirect and the expressive manner in which the message is delivered becomes critical. Much of the information is transmitted through non-verbal communication. These messages can be understood only with reference to the context. Such cultures are referred to as, *"high-context cultures."*

According to Hall, cultures also vary based on the manner of information processing. Cultures which handle information in a direct, linear fashion are called, *"monochromic."* Americans are more monochromic. Americans' fast tempo and demand for instant responses are viewed as pushy and impatient. The other type of culture is *'polychromic.'* In this culture people work on several forms simultaneously instead of pursuing a single task. Japanese and Indians belong to polychromic culture.

American businessmen consider the failure of the Japanese to make eye to eye contact as a sign of rudeness whereas, the Japanese do not want to look each other in the eye as eye to eye contact is an act of confrontation and aggression.

Examples of low context, high context cultures and monochromic and polychromic are:

Germany: Monorochromic and low context culture.

France: Polychromic and high context culture.

The possible confrontation would be a low context German may insult a high context French counterpart by giving too much information. In contrast, a German (low context) becomes upset when he feels that he does not get enough data and details from the Frenchman.

Cultural Universals

Irrespective of the religion, race, region, caste etc. all of us have more or less the same needs. These common needs are referred to as 'Cultural Universals.' Murdock has identified Cultural Universals like athletic, sports, bodily adornment, cooking, dancing, singing, education, joking, kin groups, status differentiation and dream interpretation.

The cultural universals enable the businessmen to market the products in many foreign countries with modifications. *For example, TVs*, cars, video games. Culture is not a barrier to computer software.

As such, computer software industry of the USA, Europe and Australia has been attracting most of the Indian computer software engineers. Other examples include diamonds, gold ornaments, flowers which have world wide demand. Many managers felt that Japanese would not eat *"black food"*, when Yamazaki-Nabisco thought of introducing Oreo Cookies in Japan. But the Oreo Cookies became number one cookies in Japan.

Cultural universals do not mean that two cultures are not very much close to each other.

Communication through Languages

Language is the basic medium of communication. There are more than 5,000 spoken languages in the world. The same words in the same language may mean different things in the different regions of the country.

Safe rules in international communication are:

- Overpunctuate, when you are in doubt.
- Keep ideas separate, making only one point at a time.
- Confirm discussion in writing.
- Write down all figures using the style of the person you are talking to.
- Adjust your language to the level of your foreign counterpart.
- Use visual aids whenever, possible.
- Avoid technical, sports and business jargon.

In other words, *"speak to the rest of the world as if you were answering a slightly deaf, very sick old auntie, who just asked you how much to leave for you in her will."*

Non-Verbal Communication

People also communicate through non-verbal medium. Non-verbal communication means differently in different cultures.

"As stated earlier, prolonged eye to eye contact is polite in the USA and rude in Japan, Indian and Lino cultures."

Some other non-verbal communication clues include:

- Sitting at a table around a corner signals cooperation and active listening.
- Sitting straight across from one another signals confrontation.
- Sitting side by side makes conversation awkward.
- Standing in presence of the elders and superiors signals respecting them in India.

Indians offer food or beverages to the guests first. They start eating only after the guests start eating. Americans or Europeans generally do not offer food or beverages or even water. They eat in the presence of guests without offering them. Indians respect the guests. In fact, they treat the guest equal to God *(Athithi Devo Bhava)*. *Similarly*, they respect the teacher also. They greet the guests, elders and teachers with the folded hands (*i.e.*, giving the treatment equal to God).

"Indonesians are polite people. A business guest will often be served something to drink and should not reach for his drink until the host gestures to do so. It is polite to at least taste the drink or any food offered. Indonesians are not known for their punctuality, so one should not get offended, if functions do not start on time or if your guest arrives late. Indonesians avoid the use of the left hand when offering food and other objects as it is regarded as the unclean hand. It is also considered rude to point with a finger." Most of these are applicable in India, and other Asian countries.

It is always appropriate to appreciate the cultural differences in language (both verbal and non-verbal).

Time and Culture

Time has different meanings in different cultures. Asians do not need appointment to meet someone and *vice versa.* But Americans, Europeans and Africans need prior appointment to meet someone and *vice versa.*

Friday in the Middle East is just like Sunday in the West. Time is money for Americans both for work and leisure and enjoyment. Time takes a more " leisurely walk" and there is no urgent work in most of the non-Western societies. In general, there is a lack of punctuality in Asian and African cultures. Swedish people are very prompt. Chinese are very much punctual for social occasions and appointments.

In Asian countries, particularly in India, auspicious time is most important for business deal, admission in a college, travel, starting a new project/work etc.

Space and Culture

Space between one person and another person plays significant role in communication. But culture determines the distance/space between one person and another person. Latin Americans are comfortable with a few inches of distance. Asians need substantial conversational distance and no physical contact. This is followed strictly in case of people of opposite sex. Americans need more distance from a third person for privacy. This is unimportant for Indians.

Culture and Agreement

The United States of America is a very legalistic society and Americans are very specific and explicit in their terms of agreement. The opposite is true in case of Asian countries. Asians never pick up face to face confrontation. They keep quiet in case of disagreement.

A South Korean or an Indian businessman considers a contract as loosely structured consensus statement that allows flexibility and adjustment. In Silicon Valley area of California, the culture is characterised by multiculturalism and diversity. There, American cultures are characterised by straightforward approach, while Asian cultures do not teach workers to argue point-blank with immediate superiors.

Culture of Friendship

Americans develop friendship even in a short time. In fact, they don't develop deep personal ties. Sometimes, people in the US complete the business and then develop friendship.

People in Japan and China first develop friendship through several means including eating together presenting gifts and then transact business. *(See Box 2.8)*. General Motor Corporation has learnt this culture. In Turkey, *"Let us make friends first and then see, if we can conduct business."* Once a business meeting between an American and an Italian was conducted over dinner. The Italian client appeared next morning with the signed contract. The US company, although pleased, was surprised.

Americans use the first name but the French people and most northern Europeans feel it offensive. In Germany, only relatives and close friends call by the first name. "In Australia and Venezuela, the proper waiting time could be five minutes, in Argentina, Germany and France one year, in Switzerland three years, and in Japan a decade."

BOX 2.8 CULTURE OF FRIENDSHIP THROUGH OFFER OF GIFTS IN JAPAN

Japanese show respect and willing to develop friendship through offering and exchange of gifts. Gifts create a sense of congeniality and sacrifice from the gift giver to the gift receiver. The receiver of the gift is expected to reciprocate the same in the future for more or less of the same value. This creates the implied relationship and maintains the relationship between the gift giver and receiver. Japanese avoid speaking face-to-face. So gift giving culture helps Japanese to develop relationship in the absence of speaking face –to-face.

Gift giving is the central flank in building and maintaining, even in business relationship in Japan. The gifts are in different forms including offering food to the employees who work late nights and over time. Business transactions or deals start with exchange of gifts, develop friendship. Japanese expect that the gifts should be appropriately wrapped. White and black colours should not be used in wrapping gifts as these colours are associated with death and funerals.

Culture and Negotiation

Americans are straightforward. Chinese negotiations are generally tough-minded and well prepared and use various tactics to secure the best deal.

Culture and Superstition

Superstitious beliefs like fortune telling, palm reading, dream analysis, phases of the sun and the moon, birth date and time analysis, *vaastu* are more prominent in Asian countries and also in some of the African countries. Americans knock on wood, cross their fingers and feel uneasy when a black cat crosses their path. Even Indians feel uneasy when a cat crosses their path.

Culture and Gifts

Culture attitudes concerning the presentation of gifts vary widely across the world. In Japan and India gifts are given first, but in Europe only after a personal relationship is developed. The international businessman should study the customs of the society in offering gifts. Clocks are a poor choice of gifts in China and Taiwan, Knife is poor choice in France, Russia, Germany and Thailand and Handkerchiefs in Thailand, Italy, Brazil and Venezuela.

Social Environment

Social environment consists of religious aspects, language, customs, traditions, beliefs, tastes and preferences, social institutes, living habits, eating habits, dressing habits etc. Social environment influences the level of consumption. *For example,* though the economic position of Germans and French people is more or less the same culturally they are different. Consumption level of French people is more than that of Germans. Hence, the study of social environment helps in deciding on the type of product, market, and the like. Now, we discuss various aspects of social environment.

Religion: Religion is one of the important social institutions influencing business. A few religions have spread over a large areas in the world. The Protestants' influence is dominant in the USA, Canada and Australia with regard the production and distribution. Roman Catholics dominate in Latin America, and Southern European Countries. Islam dominates northern Africa, Middle East, Malaysia, Brunei, Indonesia etc. These religions have enforced prohibition of liquor. Buddhism and Hinduism dominate in most part of Asia. It has an effect on high spiritual values, low value of material goods and more emphasis on ethics and moral values.

Religions play significant role in normal and ethical standards in production and marketing of goods and services. Most of the religions indicate in providing truthful and honest information. But most of the marketing practices deviate from these standards.

Family System: In addition to religion, family system has its impact on international business. In most of the Islamic countries, women play less significant role in the economy and also in the family with limited rights. In Latin American countries, though the role of women is better compared to that in Islamic countries, women's role is limited in economics and in families. But, women play a dominant role in European and North American countries.

In addition, joint families are more prevalent in Islamic and Hindu religions. Joint family system reduces the demand for goods and service compared to nuclear families.

Behavioural Factors Affecting Business

Cultural factors influence human behaviour. Cultural differences in various countries result in variation in human behaviour from country to country. Human behaviour that affects business includes employee behaviour, consumer behaviour and behaviour of other stakeholders. Variations in behaviour can be ascertained through the social stratification of a country. Business should consider the behavioural patterns of social groups in hiring, marketing and in selecting suppliers of inputs and market intermediaries. Behavioural patterns can be studied based on ascribed group membership and acquired group memberships. Ascribed group membership is based on gender, age, family, caste, community, ethnic, racial and nation of origin. Acquired group membership is based on religion, political affiliation, professional and social associations. These memberships influence human behaviour of a society.

Behaviour Based on Group Membership

Certain societies like the USA reward people based on performance while other societies like Malaysia reward people based on ethnic group in addition to performance. Attitudes towards female employment vary from country to country. Egalitarian societies do not discriminate employment of people based on sex, whereas Arabian countries discourage females from seeking employment. Family membership is paramount rather than individual's achievements or traits – in certain societies like India, China and Southern Italy.

Motivation and Achievement

Economic development of a country depends upon motivation of the people to work hard, and desire for achievement. This in turn depends upon the preference towards materialistic needs. Certain religions including the Hindu religion preach that people should concentrate on non-materialistic needs for salvation. This might be one of the major factors for slow economic growth of India until 1990s. According to Weber, the Protestant ethic reflected the view that work is a way to gain salvation. This belief might have influenced the people of certain countries towards hard work and material gains rather than leisure time. In fact, hard working societies led to economic development of the countries. However, most of the societies prefer to work hard with the increase in gains due to globalisation. Employees work attitudes may change as they achieve economic gains.

Interest in career success differs from society to society. People with higher interest in career success have beliefs that 'live to work' whilst people in low interest in career success countries also differ in the degree that individuals are assertive, confrontational and aggressive. These differences reflect in difference in reaction of managers of various countries. Thus some managers react to sound and smooth relations with suppliers while other managers react to cost and fast delivery. Local managers prioritise employee relations and welfare while other managers emphasise on company growth and efficiency.

People rank the motivational needs differently from country to country. People from poor countries are mostly motivated by compensation while their counterparts in rich countries are motivated by higher order needs like more responsibility, recognition, and other esteem needs.

Power Distance

Power distance denotes the relationship between superior and subordinates. People in high power distance societies like Morocco prefer little consultation between superior and subordinates. Benevolent autocratic or paternalistic styles are more appropriate for such societies. Participative and democratic leadership styles produced negative results in Morocco. People in low power distance societies like Israel, Sweden Germany and the U.S.A. participative and democratic style of leadership are more appropriate. However, subordinates in high power distance societies may prefer participative decision-making among themselves excluding the superior. A study conducted by Hofstede indicates that power distance is lowest in Israel followed by Denmark, Sweden, Germany, Australia, Canada and the USA. It is highest in Panama followed by Mexico, Indonesia, India and Brazil.

Individualism vs. Collectivism

Individualism and collectivism are the consequences of culture and affect the formation of groups, productivity and marketing practices. Culture in most of the Western countries is individualism and employees in these countries prefer to work individually. Culture in Western countries is individualism and is highest in USA followed by Australia, and UK. Culture in the Eastern countries is collectivism and is highest in Indonesia followed by Thailand, Japan and India.

Risk-Taking Behaviour

Employees in countries with the highest scores of uncertainty avoidance prefer a system and a methodological work based on rules that are not to be deviated. On the contrary, employees in countries with the low scores of uncertainty avoidance prefer flexible organizations and flexible work. People in some countries like Norway trust most of the people and people in some other countries like Brazil are very cautious in dealing with others. Cost of doing business for those whose trust is high is low and *vice-versa* for those whose trust is low as managers have to spend time in foreseeing every possible contingency and monitoring every action for compliance. Countries also differ in future orientation. People is some countries like Switzerland, Netherlands and Canada think of the future, whereas in some other countries like Russia and Poland think of the present. Belief in fatalism indicates that every event is inevitable and is due to the will of 'God'. The fundamentalists of all religions strongly believe fatalism and such people work less hard and with low self-determination. It is rather difficult to do insurance business in such societies. Uncertainty avoidance is highest in Japan followed by Spain, France and Israel. It is lowest in Sweden followed by Denmark, the UK and India.

Masculinity

Hoftstede defines masculinity as the degree to which the dominant values of a society are success, money and material things. He also defines femininity as the degree to which the dominant values of a society are caring for others and the quality of life. According to his study the country Japan enjoys highest masculinity followed by Mexico, the UK., Germany, the USA, and Australia and the country with highest femininity was Sweden followed by Netherlands, Denmark and Thailand. The countries with moderate masculinity include India, Argentina and Canada.

People in the countries with high masculinity are highly competitive and these cultures favour industrial development, entrepreneurial and economic growth. Therefore, multinational companies prefer to locate their manufacturing operations in these countries. People in the countries with high femininity favour friendly work environment and relationship oriented quality of work life.

Strategies for Dealing with Cultural Differences

Businesses should identify the cultural variations in foreign countries and evaluate their influence on human resource management, marketing, stakeholder relations etc.

Making Adjustments, wherever necessary

Business firms, after evaluating the influence of cultural variations on business practices and processes should decide the nature and degree of adjustments necessary. Host country's culture, in certain areas do not expect foreigners to adjust to them. For example, western female flight crew are permitted to wear jeans and T-shirts in public places when staying overnight in Jeddah, Saudi Arabia, even though local women are not allowed to do so. However, human resource practices need to be adjusted based on the host country culture. For example, in Saudi Arabia, a male family member accompanies women employees to the office. Similarly, business should also modify the product and other marketing practices wherever necessary based on the host country's culture. For example, Whirlpool is successful in Indian market only after modifying its washing machine to suit to wash Indian *sarees*.

Communication

Communication plays vital role while doing business in various foreign countries. Businesses should be cautious in spoken and written language, translation, and the silent language, otherwise they face serious problems in various transactions. For example, Microsoft purchased a thesaurus code for its Spanish version of word 6.0, but the meaning of many synonyms had changed and become insulting. This program was denounced by the reports of newspapers and radio. Later the company corrected the software, but by that time the company lost many customers. Poor translations may also result in tragic consequences. The collision between aircraft from Air Kazahkistan and Saudi Air in New Delhi, India was due to inaccurate translations. Therefore, appropriate technical words should be chosen in advertisements, reports, agreements and in all other business transactions.

Silent language includes using different colours to denote various meanings, keeping appropriate distance, time and status cues and use of body language. United Airlines promoted a new passenger service in Hong Kong by providing white carnations to its customers, which backfired as people in Hong Kong present white carnations only in sympathy for a family death.

Competitive Advantage: Culture of a country determines cost of doing business, productivity, entrepreneurship and innovations. Japan's culture emphasises teamwork, loyalty, reciprocal obligations and honesty. Education enhances employee commitment and increase productivity and thereby reduces cost of operations.These factors ultimately enhance competitive advantage of the business. American culture of risk taking and supportive of entrepreneurial activity helped the country in having competitive advantage in software and bio-technology industries.

Culture and Business 'Ethics'

Though the basic ethical principles are more or less the same throughout the world, specific issues are closely related to the culture of a country. Reciprocal help is a culturally bound and ethnically valued principle in China in the form of *'guanxi'*. *Guanxi* means giving a gift or money to others (including Government officials) for the help they rendered. This type of gift in must of the other countries is treated as bribery and corruption. But this is a practice of building network and relationship in China.

Employment of child labour is ethically unaccepted in many countries. But, the child labourers in poor countries are denied even food by abolishing or denying employment to them. However, though these practices seem to be culturally ethical for special societies, in the narrow point of view, they are regarded as unethical from the larger and long-run point of view.

Thomas Donaldson suggests that international business firms should be guided by the following ethical principles:

- Respect for core human values and human rights
- Respect for local tradition
- Taking the situational factors into consideration while deciding what is ethical and what is unethical.

Impact of Culture on Consumer Behaviour

Culture influences the behaviour of the consumer. Montrose, Sommers and Jerome Kernan have made a beginning in this direction. They identify the value orientations that underline market behaviour as falling in six categories:

(1) Egalitarian or elitist; *(2)* prone to lay stress on accomplishment or on inherited attributes; *(3)* expected material or non-material rewards; *(4)* evaluating individuals or products in terms of objective norms or of subjective standards; *(5)* focused on the distinctiveness of the parts (intensiveness); and *(6)* oriented towards personal rather than toward group's gain. The U.S. consumer tends to have the attributes described by the first term in each pair. British attitudes tend to fall on the opposite side. A number of examples illustrate the significance of these differences. *For example:*

"When performance orientation is coupled with a predisposition to be intensive — *i.e.,* to perceive many separate and distinct needs to be acted upon as well as a variety of ways in which these needs can be served — the probability of accepting new contingencies as real is greater than when an extensive value orientation prevails. Americans see more separate and distinct activities plus more separate and distinct products which can be used in their performance than do Canadians, Australians or Britons. Such a disposition supports them market for gadgets, the great array of household appliances and accessories." *(See Box 2.9)*

BOX 2.9 **CULTURE BASED MARKET SEGMENTATION**

A medium-sized Swedish engineering company manufactured fire-fighting equipment, but was incurring losses. In 1983 a new marketing director was appointed. After four years of work, turnover rose from £3 million to £10 billion and profitability was restored, mainly on the basis of a complete reappraisal of markets and marketing policy.

The marketing director found that the company had been dealing with about 100 country markets, but many produced orders only in small quantities, and these intermittenty. In total, the orders were surprisingly small in proportion of the turnover, but were just as costly and time-consuming to service as orders from the larger, steadier markets.

A careful process of selection showed that if the company concentrated more extensively on 50 markets its chances of progress would improve, and of these 50, some 10 which looked the most promising were selected for constant and increasing attention; *for example,* visits were planned with increasing frequency. The company found that this core of key markets provided an almost ideal ratio, because where concentration is carried to the limit of five or six countries accounting for 75 per cent of trade, a contraction of business in those few countries could prove very harmful. Recognising important national differences among the 10 key markets, the company was able to develop and deploy regional sales specialists to deal more effectively with local issues and customer contracts. Thus, by reducing the total number of markets, but retaining those with significant trade, the company improved its profit performance.

Source: Edgar P. Hibbert, *International Business,* p. 80.

Religions and Economic Implications

Though there are a number of religions in the world, four religions are widely believed and followed by majority of the people *viz.,* Christianity, Islam, Hinduism and Buddhism. The impact of religions on business is mostly in developing attitudes of people towards work, product/service price fixation, entrepreneurship and cost of doing business.

Christianity: Christianity is the major religion in the world and is the monotheistic religion (i.e., belief in one God). The major branches of Christianity include the Roman Catholic Church, Orthodox Church, and the Protestantism. According to Max Weber, there is a relationship between Protestantism and the spirit of capitalism. According to him, Protestant ethics emphasises the importance of hard work and creation of wealth as God feels happy when wealth is created. Protestants also believe in reinvesting wealth for further development of wealth rather than consume it for a long run benefit. Thus, hard work and further investment of wealth led to the emergence of capitalism and economic development in Western Europe and at a later stage in the United States of America. According to Weber, business leaders, owners of capital, high skilled labour, technically and commercially trained personnel of modern enterprises are protestants.

Weber felt that Catholics did not contribute to the same level of economic development like Protestants as the former promise of salvation in the next World. Further, the individual religious freedom provided by Protestants paved the way for individual economic, social and political freedom and emergence of entrepreneurial activity.

Islam: Islam is the second largest religion and is a monotheistic religion. According to Islam, those who pursue riches on the earth may gain them, but those who forego worldly ambitions to seek the favour of Allah may gain the greater measure i.e., entry into Paradise. Islam is an all-embracing way of life governing the totality of Muslims. Economic Principles of Islam are pro-free enterprise. The Koran approves doing business and earning legitimate profits. Islam asserts that all property is a favour from Allah and those who hold property, are regarded as the trustees who are entitled for receiving profits. They have to use the property for righteous and socially beneficial purposes. Thus Islam reflects social justice. Islam is in favour of international business as long as these business houses do their business consistent with Islam ethics. Islam prohibits the payment or receipt of interest. But it allows for sharing of profit of the borrower or mark-up the loan amount.

Hinduism: Hinduism is the oldest religion in the world. Hindus believe that they should conduct themselves in an ethical way in order to protect the morals of the society called *dharma.* They believe in that God protects those who protect *dharma*. Hindus also believe *Karma* principle which states that how ethically a person conducted activities during his/her previous incarnations determine his/her activities in the present lifetime. According to Hinduism, an individual can eventually achieve *nirvana* (a state of complete spiritual perfection that render reincarnation no longer necessary). Hindus believe that one should channel all his/her efforts towards spirituality ignoring material benefits in order to attain *nirvana* as materialism is temporary and only *nirvana* is permanent spiritually. In other words material achievement cannot be carried over to next incarnation and only spiritual achievement would be carried over to the next incarnation.

Max Weber argued that ascetic principles embedded in Hinduism do not encourage the entrepreneurial activity in pursuit of wealth creation found in protestants. According to Weber traditional Hindu values emphasise that individuals should be judged by their spiritual activities and achievements but not by their materialistic achievements. Therefore, pursuit of material well-being would be a hindrance for attainment of *nirvana*. As such Hindus, traditionally, were less likely to engage in entrepreneurial activity than protestants. However, the current young generations, view a different meaning of Hinduism as protestants of Christianity did quite earlier. This different meaning is that, 'work is worship' and one can attain *nirvana* through the path of *Karma Yogam* (by working hard and mastering the activity in which one is engaged). With this different approach, entrepreneurial activity has picked-up in India particularly after globalisation.

Buddhism: Siddhartha Gautama – An Indian prince founded Buddhism in the sixth century B.C. According to Buddhism life is comprised of suffering and misery is everywhere. Buddhism suggests for systematically following the Noble Eightfold Path i.e., right seeing, thinking, speech, action, living, effort, mindfulness and meditation. Though, Buddhism does not advocate ascetic behaviour, it emphasis spiritual achievement rather than material achievement. Therefore, Buddhism also does not support entrepreneurial activity compared to the Protestantism. However, it would provide as base for entrepreneurial activity.

Confucianism: Confucianism was founded in the fifth century B.C. It is popular in China, Korea, Japan and Taiwan. It emphasises on right action for attainment of salvation. Three main aspects of Confucianism include loyalty, reciprocal obligations and honesty in dealing with others. Loyalty to superiors and elders is regarded as a sacred duty and absolute obligation, which makes human resource management less complicated. Reciprocal obligations make the management to reward the loyal employees adequately. Otherwise, the loyal employees may not continue their loyalty to the superior. China's culture of *Guanxi* is a network relationship supported by reciprocal obligations. Japanese employees are loyal to employers and employers in turn provide lifetime employment.

Confucianism also emphasises that honest behaviour is essential in all transactions. Though the dishonesty pays in the short run, it produces negative results in the long run. Companies that trust each other and deal in honest transactions prosper in the long run. Companies under Confucianism societies honour contractual agreements and obligations. Japan gains competitive advantage partially due to the business culture embodied in the Confucianism.

(C) TECHNOLOGICAL ENVIRONMENT

Meaning of Technology

Most of the people did not believe the arrangement made by 'Lord Sri Krishna' to 'Dhrutharastra' to get the information of 'Kurukshetra War' instantly until the live telecast of *'cricket match'* through TV became reality. *Similarly*, we did not believe the power of god's 'Divine Vision' *(Divya Drushti)* until the video conferencing was introduced. *Similarly*, the power of the *'click-the-mouse'* and *'get whatever you need at your door step'* became reality while some of us did not believe the power of God waving his hand in the air like clicking the mouse on the computer and fulfilling the desire of his devotees. The days of *'touring-the-world within hours'* like *'Narada'* are not far-off. In fact, NASA has been researching in this direction and came up with an aeroplane which could reach from one part of the world to the other part of the globe within two hours.

Thus, the illusions are becoming reality mostly due to technology. Man of the third millennium is able to see any part of the world, get any product from any country, get messages from all over the globe with bare minimum cost by simply staying at his home or office. The distance is shrunken among the countries due to technology. All this, *'once-up-on-a-time's'* illusion has become reality. The latest information technology has dissolved the national boundaries and the advancements of transportation technology have reduced the distance among the world nations.

These technological changes enabled international business to take the shape of transnational business through the concept of global business. International business, in fact, gained significance due to the amazing advancements in technology.

Technological environment has significant and direct influence on business in general and international business in particular. Technology is the application of knowledge. J. K. Galbraith defines technology as "a systematic application of scientific or other organised knowledge to particular tasks". Technology advanced phenomenally during the past 50 years.

Technology changes at a faster rate. In fact, it brings change in the society, economy and politics. Technology affects all walks of life, all countries and the entire globe. As stated by Alvin Toffler, "Technology feeds on itself. Technology makes more technology possible." Thus, technology is self-reinforcing. Technology brings the globe closer. Technology flows from the advanced countries to the developing world through the multinational corporations (MNCs), joint-ventures, technological alliances, licensing and franchising.

Influence of Technology

Technology influences the way we live, we cook *(electric rice cooker)*, we drink even water *(filtered and mineral water)*, communicate *(telephone, fax, e-mail, video conferencing, e-mail chatting etc.)*, preparing for a class or a case or reading a newspaper through the internet, marriage alliances through the internet, computer aided design, production, selling *(e-commerce)*, satellite networks, electronic fund transfers, lasers, fibre optics, unmanned factories, miracle drugs, new diagnostic methods. New studies in technology like eye replaces the password (*See Box 2.10*) and using the remote for car driving (*See Box 2.11*) will take place.

BOX 2.10 NOW, EYES REPLACE PASSWORD

Password cracking programmes can break a lot of easily guessed phrases in less than a minute.

And heightened security of airports, borders and sensitive facilities is the focus of a world newly awakened to the threat of global terrorism.

Countries and companies want security that is harder to fool than systems that rely on passwords and PIN numbers.

Enter biometrics, the highly-hyped technology that relies on unique physical characteristics such as finger-prints, facial patterns or the pattern of the iris in the eye to make sure users are who they say they are.

Source: Adapted from *Deccan Chronicle,* December 30, 2002.

BOX 2.11 GLOBAL POSITIONING SYSTEM (GPS) TECHNOLOGY AND CARS

When installed in a car, a GPS unit can provide useful information about the car's position and the best travel routes to a given destination by linking itself to a built-in digital map. A monitor in the car shows the relevant portion of the map. GPS also tracks the distance travelled on a particular trip, vehicle mileage, and speed. GPS can aid in the recovery of a stolen car.

The Ford automobile company has developed a new telematic system through GPS on the Ford Focus, that will alert emergency services when an airbag deploys. The emergency services can locate the vehicle quickly and provide assistance to an injured driver or passengers.

Source: Tradekey

Investment in Technology

Advanced countries spend considerable amount on research and development for further advancement of technology. Germany spends 50% of its R & D budget on product innovation and the remaining 50% on process innovation. Japan spends only 30% on product innovation and the remaining 70% on process innovation. In contrast, the USA spends 70% on product innovation and only 30% on process innovation. The Japanese auto manufacturers gained incredible competitive advantage over the US counterparts by reducing new product's time to market. Japanese companies introduce the products in three year whereas the US firms need five years for the same job.

Japanese are investing money in innovations and creations in biotechnology. Others also follow Japan as this is an emerging area.

Exhibit 2.1 shows the ranks of Asia-Pacific countries in technology development/advancements.

EXHIBIT 2.1 MAJOR INVESTORS ON TECHNOLOGY IN ASIA-PACIFIC REGIONS IN 2003

	Percentage of spending on technology to total investments
Australia	15
China	12
Japan	14
New Zealand	13
Singapore	6
India	11
Korea	10

Source : Deloitle Touche Tohmarty, Technology Fast 500 Asia-pacific, 2003.

Technology and Economic Development

Technology is one of the significant factors which determines the level of economic development of a country. The difference between the nations is mostly reflected by the level of technology. *For example,* though India had vast natural resources, it remained as a major importing country due to its low level technology before 1991. Japan with its high level technology could export finished goods to India, by importing the raw materials from India itself. Thus, though Japan is endowed with poor natural resources, the Japanese became rich and advanced due to technology.

As such, developing countries allow MNCs entry into their countries in order to have benefits of the latest technology and to develop the domestic industry. But often, it is criticised that the MNCs transfer obsolete technology to developing countries.

Technology and International Competition

Nations develop economically when they translate science into useful technology and in turn create wealth from innovations. Innovation is the useful adaptation of science or knowledge including invention of new products or processes. Invention is creation of entirely new. A few companies or people invent but many companies adapt scientific knowledge to generate wealth by application and commercialisation.

Major inventions or discoveries do not remain properly for a longer period. The inventions or innovation process and global competitiveness are two determinants of a nation's wealth. Japan concentrates on process innovation in automobiles, steel, telecommunication and microelectronics while Germany concentrates on innovations in chemicals, pharmaceuticals, automotive engineering, medical instruments and machine tools. Italy concentrates on innovations in textiles and leathers.

Table 2.1 presents contrasts in research and development for selected countries.

TABLE 2.1 CONTRASTS IN RESEARCH AND DEVELOPMENT FOR SELECTED COUNTRIES

	U.S.A.	Japan	Germany	France	U.K.	Italy
Percentage of R&D expenditure to total G.N.P	3.1	2.0	2.9	2.3	2.2	1.2
Percentage of private R&D expenditure to total R&D.	51.4	78.4	62.5	40.1	49.8	41.3
Percentage of Business-related R&D	77.5	68.2	74.1	52.8	69.0	55.2
Percentage of scientists Engineers to total population	0.34	0.49	0.27	0.21	0.24	0.12

Source: Quoted in David H. Holt and Karen W. Wigginton, *"International Management"*, Thomson, 2002, p.53.

Technology Transfer

Technology and global business are interdependent. International business spreads technology from advanced countries to developing countries by:

- establishing the subsidiaries in developing countries
- establishing joint ventures with the host country's companies
- acquiring the host country's companies or by merging with the host country's firms
- arranging technological transfer to the companies of developing countries through technological alliances.

Technology Transfer as Innovation

Technology transfer is mostly concerned with the introduction of existing technology to other countries, preferably to a less advanced country through international business operations. Procter & Gamble introduced less costly products like soaps and shampoos for Chinese in China in 1988 rather than diapers and sanitary napkins – that gave the company market advantage over the competitors.

Companies take the familiar products in the home market to the foreign markets that are new there. Colgate–Palmolive introduced wide range of its products to developing countries. In this process, MNCs bring new products, new processes and technologies to the host countries. These may be old in the home countries, but relatively new in the host countries. Therefore, various developing countries invite the MNCs to bring technology to their country that is non-available there.

Managing Technology Transfer

Foreign companies, when they establish manufacturing facilities in host countries bring technology, technical know-how, machinery and equipment, management know-how, marketing skills etc., to the host country. They train the local employees in carrying out various operations including production. They design process technologies and products either in home country or host country. However, they take all precautions in protecting intellectual property. Other information and knowledge is transferred to the local employees. Technology transfer takes place to a larger extent in joint ventures. However, the parent companies normally will not part with the significant part of the technology in order to safeguard their interest and profit.

Technology and Location of Plants

In addition, MNCs relocate their manufacturing facilities based on the technology. In other words, MNCs locate the plants with high technology in advanced countries and establish the labour driven manufacturing facilities in developing countries, in order to get the advantages of cheap labour.

Scanning of Technological Environment

The level of the technology is not the same in all the countries. Advanced countries enjoy the fruits of the latest technology while the developing nations face the consequences of obsolete or outdated technology. Therefore, the MNCs have to understand the technology, analyse it before entering the foreign markets. MNCs have to procure the technological environmental information regarding:

- The level of technology of the industry in the home country.
- The level of the technology of the industry in the proposed host country.
- Compatibility of the home country's technology with the host country's technology.
- If the technology is not compatible, then select the appropriate technology for the host country, if possible. If not, select the host country's technology that suits the home country's technology.
- Study the compatibility of the technology to the culture of the host country including the taste and preferences of the host country's customers.
- Study the host country's governmental policies regarding technology transfer.
- Study the modes of technology transfer like joint ventures, technological alliances etc.
- Study the impact of the technology on the environment of the home country including the laws pertaining to environmental pollution.

Appropriate Technology

As indicated earlier, technology that suits one country may not be suitable to other countries. As such the countries develop appropriate technologies which suit their topographical conditions, climatic conditions, soil conditions, conditions of infrastructure etc.

For example, Japanese automobile industry and Korean automobile industry design different types of cars which suit the Indian roads.

Technology and Globalisation

The industrial revolution resulted in large-scale production. Added to this, the recent technological revolution led to the production of high quality products at lower costs. These factors forced the domestic companies to enter foreign countries in order to find markets for their products. Thus, technology is one of the important cause for globalisation.

Information Technology and Globalisation

As indicated earlier, the information technology redefined the global business through its developments like internet, www sites, e-mail, cyberspace, information super highways. Computer Aided Design (CAD), Computer Aided Production (CAP) and on-line transactions brought significant development to the global business. These facilities, according to M.J. Xavier, help the global companies in:

- Reducing the size of inventories
- Reducing delivery time
- Reducing unproductive waiting time
- Reducing the incidents of stock-outs and lost sales
- Responding to market changes at a faster rate
- Reducing rush orders.
- Cutting down over production
- Reducing unnecessary movements of forwarding and back-tracking
- Reducing paper work and wasteful process
- Planning production levels accurately
- Reducing/avoiding physical movement of employees, suppliers, and customers.

MNCs have to understand and analyse more of economic environment of the foreign countries for strategy formulation.

Hence, we now discuss the economic environmental factors of the global countries.

(D) ECONOMIC ENVIRONMENT

The economic environment of various countries mostly and directly influences international business. In fact, international economic environment and global business interact with each other. Global economy has undergone a sea change during the last 50 years. The change was revolutionary after 1990. The results of these changes are the emergence of global markets, establishment of World Trade Organisation, emergence of global business houses and global competitors rather than local competitors. The major changes include:

- Capital flow rather than trade or product flow across the globe.
- Establishment of production facilities in various countries.
- Technological revolution delinked the relation between the size of production and level of employment.
- Primary products are delinked from the industrial economies.
- The macroeconomic factors of individual nations independently do not significantly control the global economic outcomes.
- The contest between 'capitalism' and 'communism' is over. Capitalism succeeded over communism/socialism as a model for the organisation of economic activity.

Economic Systems

Economic system is an organisation of institutions established to satisfy human needs/wants. There are three types of economic systems, *viz.*, capitalism, communism and mixed. Economic systems are based on resource allocation in the system. They are market allocation in case of capitalistic, command/central allocation in case of communistic and mixed allocations in case of mixed economic system. In fact, there are no examples of pure capitalistic or communistic economies. All actual systems are mixed economic systems of varied degrees of market allocations and command allocations.

Capitalistic Economic System: Under this system, customer allocates resources. Customers' choice for product/services decides what will be produced by whom. This economic system provides for economic democracy, thus giving the customer, his choice for products/services.

This system emphasises the philosophy of individualism believing in private ownership of production and distribution facilities. The limitation of this economic system made the Governments introduce the welfare state concept which includes: workmen's compensation law, provision for social security, labour legislations for state and housing, agriculture, medical, food, transportation, communication, security, education, water, power supply etc.

The USA, Japan and the UK are the examples of capitalistic countries. Most of the other countries like India, France, Italy and Malaysia have started shifting their economic systems towards this economic system.

Mixed Economic System: Under this economic system, major factors of production and distribution are owned, managed and controlled by the state. The purpose is to provide the benefits to the public more or less on equity basis. The other factors of mixed economic system are development of strong public sector, agrarian reforms, control over private wealth, regulation of private investment and national self-reliance.

This system does not distribute the existing wealth equally among the people, but advocates the egalitarian principle. It believes in full employment, suitable rewards for the workers' efforts. This is also called 'Fabian socialism.'

As mentioned earlier, there is no pure capitalistic system or communistic economic system. All capitalistic systems have a command sector and communistic systems have a market sector. The command sector accounts for 32 per cent in the USA, 40 per cent in India and 64 per cent in Sweden.

The trend that is taking place in the globe today is the move towards privatisation, *i.e.,* move towards market allocation. The UK, France, Holland and India, *for example,* have reduced their command sector after 1990.

Communistic Economic System: In this, economic system, private property and property rights to income are abolished. The state owns all the factors of production and distribution. Communism is also called Marxism. Lenin set up a communist state in Russia after the Great October Revolution of 1917. Later, the ideology spread to Czechoslovakia, China, Rumania, Yugoslavia, Poland and Sweden. Most of the East European countries follow the Marxist ideologies.

In communistic/command allocation countries, the resource allocation decisions are made by the government planners. The number of automobiles, shoes, shirts, television sets — their size, colour, quality, features etc., motor cycles, scooters are determined by government planners. Under this system, consumers are free to spend their income on what is available.

The major limitations of this system include:

- It reduces individual freedom of choice due to restrictions on items to be produced.
- IT imposes too many restrictions on MNCs and FDI *(See Box 2.12)*
- It fails to get total commitment of people to work and country's welfare.
- It failed to achieve significant economic growth.
- It could not achieve equality - the main plank of Marxism.
- The rules of this system did not set fine examples for the executors to follow or implement.
- It has been obsessed with rights of workers.
- It provides less scope for foreign investment and business *(See Box 2.12)*.

Communism collapsed in the former USSR. Similarly, communism collapsed in most of the African countries. This is mostly due to the changes towards privatisation. The degree of command allocation has been declining even in China. Cuba is an example of the last remaining predominantly communistic country.

BOX 2.12 COMMUNISM AND McDONALD'S

After long negotiations between McDonald's and Soviet officials, the former entered Russian market in 1990. Moscow city council was a partner of McDonald's in the Russian Joint Venture. But McDonald's faced with severe shortages in supply of building materials to build the restaurant as these requirements were not included in the central plan. The company was not provided with sufficient supply of wheat floor, sugar, mustard either due to non-inclusion in the central plan or due to inability of Soviet manufacturers to deviate from their standard output or due to the strict control that Soviet manufacturers should sell to the Soviet companies. Another problem was that certain products like iceberg, lettuce, Pickling cucumbers and the Russet Burbank potatoes used for McDonald's French fries were not produced or consumed in Russia. McDonald's educated Soviet farmers and cattle ranchers on how to grow and raise the products it needed.

McDonald's did not face any problem in respects of employees and customers and advertising. Russian television covered the event; it became almost impossible to accommodate the customers for the first time in January 1990, even though the Moscow's restaurant was biggest in the world. Customers preferred its food though it was five times costlier than the normal local meal. Despite the crisis in 1998, McDonald's grew in Russia and had 73 storages by the end of 2001. McDonald's success in Russia enabled it to enter China and also become successful there.

Source: Adapted from John. D. Daniels, *et.al., 'International Business',*

Countries classified by Income

The World Bank categorises economies into one of the following groups according to the per capita gross national income in 1999

Low Income countries	US$ 755 or less
Lower Middle Income countries	US$ 756 to US$ 2, 995
Upper Middle Income countries	US$ 2996 to US$ 9,265
Higher Income countries	US$ 9,266 or more.

The World Bank refers to the low and middle-income countries as developing countries. High-income countries are referred to as developed or industrialised countries. However, it does not mean that these countries have reached a stage of final development. The USA, the UK, Japan, Italy, Australia among others are classified as high income countries while Brazil, Hungary, Malaysia, Mexico, and Saudi Arabia are classified as upper – middle income countries, Botswana, China, Fiji, Indonesia, Papua New Guinea, Solomon Islands and Sri Lanka are categoried as lower-middle income countries and Eritrea, Ethiopia, India, Pakistan and Bangladesh are grouped under lower-income countries.

Exhibit 2.2 presents the comparison of capitalistic, communistic and mixed economic systems.

EXHIBIT 2.2 CAPITALISM, SOCIALISM AND COMMUNISM COMPARED

Characteristics (1)	*Capitalism (2)*	*Socialism (3)*	*Communism (4)*
Economic Markets	Freedom to compete with the right to invest.	Limited competition with State-owned industries.	Absence of competition with State-owned markets and industries.
Individual Incentives	Profits and wages in relation to one's ability and willingness to work.	Profits recognised. Wages fairly in relation to efforts.	Profits not allowed. Workers urged to work for the glory of the State.
Capital Sources	Capital invested by owners who may also borrow on credit. Capital may be reinvested from profits. Depreciation is legal.	Obtained from owners and from State-issued bonds for State-owned industries. Depreciation permitted.	State provides all resources to start business owned by the State. No depreciation.
Labour	Workers are free to select an employer and an occupation.	Workers allowed to select occupation. State planning encourages employment.	The State determines one's employer and employment.
Management	Managers are selected on the basis of ability. Managers have freedom to make decisions.	Managers in State-owned industries are answerable to the State. Non-monetary rewards emphasised.	Key managers must be party members. Absence of freedom to make decisions.
Business Ownership	Individuals have the right to own a business and to contract with others.	State owns the basic industries. Other businesses may exist.	State owns all productive capacity including communes.
Risk Assumption	Losses assumed by owners. May transfer business risks to other businesses through insurance.	People assume risks of State-owned industries. Losses taken from taxes.	Economic production owned by the State. Risks assumed by the State. Losses reduce standard of living.

Source: Vernon A. Musselman and Eugene H. Hughes, *Introduction to Modern Business–Issues & Environment,* p. 20.

Low-Income Countries: These countries are also known as third world countries or pre-industrial countries. Characteristics of these countries include:

- Limited industrialisation, and excessive dependency of population on agriculture.
- High birth rates.
- Low literacy rates.
- Heavy reliance on foreign aid.
- Political instability and unrest.
- Concentrated in Africa, South of the Sahara.
- Excessive unemployment and underemployment.
- Technological backwardness.
- Underutilisation of natural resources.
- Excessive dependency on imports.

- Industrial development is characterised by consumer goods industries.
- The vicious circle of poverty.

Lower-Middle-Income Countries: These countries are also known as less developed countries. Characteristics of these countries include:

- Early stages of industrialisation.
- Expansion of consumer markets.
- Availability of cheap and motivated human resources.
- Domestic markets are dominated with the products like clothing, batteries, tires, building materials, packaged foods etc.
- Locations for production of standardised/mature products like clothing for exports.
- Pose threat to the rest of world in labour-intensive products due to cheap labour.
- Have competitive advantage in mature and labour intensive products.

Upper-Middle-Income Countries: These countries are also known as industrialising countries.

Characteristics of these countries include:

- Less dependence on agriculture.
- Occupational mobility of the people from agriculture to industry.
- People migrate from rural to urban areas which results in increased urbanisation.
- Increase in literacy, formal education and increased wage rates.
- Low wage costs compared to advanced countries.
- Formidable competitors due to lower wage costs and with the capability of advanced countries.
- High exports and rapid economic development.

High-Income Countries: These countries are also known as advanced countries, industrialised, post industrial or First World countries.

The characteristics of these countries include:

- Oil-rich countries are excluded from this category.
- Countries reached the income level of more than US $ 9,655 through the process of industrial growth are included in this category.
- Countries developed through the codification of theoretical knowledge rather than from random inventions are included in this category.
- Service sector contributes more than 50 per cent to the GNP.
- Development of information sector.
- Development of intellectual Technology over machine technology.
- Domination of scientists and professionals over engineers and semi-skilled workers.

- Emphasis on the future plans.
- Japan's work culture (mainly co-operation and harmonious interaction) suits to the basic requirements of post industrialised society.
- The UK's work culture (mainly distrust and absence of sound relations) is in contrast to the needs of rapid industrialisation.
- High income countries mostly aim at building the information society.
- These countries face the problems like pollution, excessive urbanisation, economic depression, increase in aged population etc.
- Deindustralisation is in the process in these countries. These countries shift to information society.
- Product innovations are more prevelant in post industrial society compared to that in industrial society.

Exhibit 2.3 presents the comparative analysis of pre-industrial, industrial and post-industrial societies.

EXHIBIT 2.3 THE INDUSTRIAL SOCIETY: A COMPARATIVE SCHEME

Modes (Mode of Production)	***Pre-industrial (Extractive)***	***Industrial (Fabrication)***			
Economic sector	Primary Agriculture Mining Fishing Timber Oil and gas	Secondary Goods producing Manufacturing Durable Non-durables Heavy construction	Tertiary Transportation Utilities	Quaternary Trade Finance Insurance Real estate	Quinary Health Research Education Government Recreation
Transforming resource	Natural power Wind, water, draft animals human muscle	Created energy Electricity – oil, gas, coal Nuclear power	Information Computer and data transmission systems		
Strategic resource Technology	Raw materials Craft	Financial capital Machine technology	Knowledge Intellectual technology		
Skill base	Artisan, manual worker, farmer	Engineer, semiskilled worker	Scientist, technical, and professional occupations		
Methodology	Common sense, trial and error, experience	Empiricism, experimentation	Abstract theory: models, simulations, decision theory, systems analysis		
Time perspective	Orientation to the past	Ad hoc adaptiveness, experimentation	Future orientation, forecasting, and planning		
Design	Game against nature	Game against fabricated nature	Game between persons		
Axial principle	Traditionalism	Economic growth	Codification of theoretical knowledge		

Source: Physics Today (February 1976), p. 47.

Basket Cases: Basket cases are countries which are unattractive for investment and operations due to economic, social and political problems. Some are low income countries like Rwanda. Some of them are affected by civil wars. Republics of former USSR are the best examples for this.

Location of Income: Income level is the most valuable factors for determining business in the international arena. However, income alone cannot determine the market as it is not an accurate measure of potential.

The USA, Canada, Japan, and European Economic Area represent the major share in world's GNP among the high income countries. 77 per cent of the world income is concentrated in the triad, *i.e.,* the USA and Canada, European Union and Japan. For most of the consumer and consumer durable products income level is not the major criteria due to income inelasticity of demand.

Location of Population: Ten most populous countries in the world account for 57 per cent of world income. Five largest countries account for 37 per cent. Most of the income is concentrated in the high-income and high-population countries. International business can concentrate in these countries.

Population is the major consideration for low priced products. In fact, India and China account for two-fifths of the world population. The ten most populous countries account for two-thirds of the world population.

Business and Economic Development

Business helps for identification of people's needs, wants, production of goods, supply them to the people. Thus, it creates for the conversion of inputs into output and enables for consumption. Ultimately, it leads to economic development. The developing countries concentrate on allocation of scarce resources, increasing production and productivity to meet the growing needs of the population. Further, business also streamlines the distribution of goods from the manufacturing centres to the customers. International business houses establish their manufacturing centres in various countries and distribute the goods to the customers of a number of countries. Thus, international business contributes to the economic development.

Macroeconomic Issues Affecting Business Decisions

Various macroeconomic issues like economic growth, inflation, balance of payments and transition to market economies affect business decisions.

- **Economic Growth:** The high economic growth rate of the countries lift the quality of life of their citizens in addition to providing an opportunity of expanding marketing share to international business firms. The stagnation or decline in economic growth of countries result in intensive competition among the companies to retain their market share and/or to increase their market shares. The stagnation in global economy in 2001 and 2002 led to aggressive competition among the international business firms.

Managers of the multinational companies are interested in knowing the future economic growth rates of various countries in order to select the market either to enter or concentrate or to commit more resources to the market. According to the Organisation of Economic Cooperation and Development (OECD) the global economic recession in 2001 was highest in the last 20 years. The U.S.A. and European Union started recovering after this recession at a faster rate than that of Japan. However, China and India recorded continuous growth rates of around 7 per cent and 6 per cent, respectively. Managers of multinational companies should know the growth rates of different countries on a continuous basis in order to avert possible failures and enhance their market shares.

- **Inflation:** Inflation is another important factor that affects the market share of international business firms. Inflation affects interest rates, as the demand for money is high due to higher prices. Banks increase interest rates in order to attract deposits and governments raise interest rates with a view to combat inflation. Inflation also affects the exchange rate of the domestic currency in terms of various foreign currencies. Inflation weakens the domestic currency and thereby makes the exports dear and imports cheap.

  Inflation forces the people to spend their incomes immediately as happened in Brazil in the early 1990s when the inflation was rising at the rate of 1 per cent per day. High inflation affects exporting firms adversely and importing firms favourably. The rate of inflation has been declining since 1990. It came down from 4 per cent in early 1990s to 2.5 per cent in 2000 in advanced countries. International business managers have to continuously monitor inflation rates in order to manage cash flows in such a way that the adverse effects of inflation are kept at a minimum as managed by Pizza Hut in Brazil during 1990s.

- **Balance of Payments:** Balance of payments position of a country is the outcome of international business and also affects the future of international business. Export and import trade in goods and services affect current account position and flow of capital affects the capital account position. Excessive imports of goods, services and capital over exports result in a negative balance of payments. Continuous negative balance of payments will lead to currency instability and control over imports and incentives to boost exports. Excessive imports over exports in the USA led to the decline in value of US dollar in the late 2004 and early 2005.

  Excessive imports over exports also lead to external debt from foreign countries and international financial agencies. Heavily indebted countries in the world are Brazil ($ 238.0 billion) Russia ($ 160.3 billion), Mexico ($ 150.3 billion), China ($ 149.8 billion), Argentina ($ 146.2 billion) and Indonesia ($ 141.8 billion). Most of these countries have G.D.P. higher than the external debt. Many African countries have external debt in excess of G.D.P. Many foreign investors pumped money into Argentina as the currency was pegged to U.S. dollar even when the economy was in recession in 1996. Argentina kept spending heavily and this resulted in Argentina's default to the tune of US $ 155 billion in external debt – the largest default by any country in the history.

Managers of multinational companies should monitor the balance payments positions of the countries where they operate in order to take preventive measures rather than becoming a part of the debt trap or its adverse effects as happened in Asian crisis.

- **Economic Transition:** Many former communist/command economies and mixed economies are undergoing transition to market economies due to the failure of central planning and public sector to generate economic development. The collapse of the former U.S.S.R. and the break-up of the Berlin Wall and foreign exchange crisis in India in 1991 and the opening up of China towards extensive international trade paved the way for increased globalisation of business. This process enhanced the interest of the multinational companies in carrying out the business in many parts of the world and conversion of many national companies in various countries into multinational companies.

Economic Transition Includes

- Liberalising economic activities, prices and market operations along with reallocating resources to their most efficient use.
- Dispensing with licensing system and regulated markets.
- Developing indirect, market-oriented instruments for macro-economic stabilisation.
- Achieving effective enterprise management and economic efficiency usually through privatisation.
- Imposing hard budget constraints which provide incentive to improve efficiency.
- Creation and establishment of institutional legal framework to secure property rights, the rule of law and transparent market entry regulations.

As indicated earlier, many countries initiated transformation from different economic systems like communism/socialism and mixed economies to market economies and they are in different stages of the transformation process. Most of these countries came across with various disabling factors such as:

- Opposition to liberalization, privatisation and globalisation due to the vested interests of various groups and political parties.
- Ineffective enforcement of laws, rules and regulations due to the underground and virtual economy.
- Prevalence of corruption and illegal activities
- Freezing of market transformation resulted in financial instability, low growth or reverse growth of the economy.

Many countries that faced these problems during the initial stages of transformation eventually overcome these problems. And some of the countries are in the process of overcoming these problems. Countries those overcome these problems experience the following environment or situation factors in the transformation process.

- Spread of benefits of market economy
- Strong fiscal position in terms of increase in government income.
- Increase in confidence in banks and other financial institutions
- Growth in industrialisation, employment and output
- Increase in credibility and financial position of the government
- Improvement in Government's financial ability to finance and administer social safety net.
- Early recovery and adjustment to the market economic situations.
- Steady progress towards open and liberal markets.
- Development of market-friendly environment
- Growth in foreign and domestic investment, further industrialisation, employment, output, living standards and quality of life of the people.

Opportunity to MNCs

The process of liberalisation and transition provided significant opportunity to the multinational corporations to enter most of the countries of the world either by locating their manufacturing facilities or extending their markets or both. Privatisation helps multinational companies to acquire pubic sector companies in the liberalised economies. Thus, MNCs are the immediate and greatest beneficiaries of liberalisation. privatisation and globalisation of world economies.

Transition Process

Transition process varies from country to country. Russia changed both economic and political systems simultaneously. As such, the country faced severe consequences during the early stage of the process. Now, the country is comparatively comfortable in the transition process as the administrative constraints have disappeared. In contrast, China opted for only economic transformation by strongly holding its political system of totalitarianism. China's economic growth rate is higher than that of other countries. India is the largest democracy in the world and it opted for economic transformation from mixed economy to market economy. India's economic growth rate is also significant compared to that of many countries in the world, though; it is a little bit less than that of China.

Economic vs. Social Issues in Transition

Though the transition has set trends for economic growth of at least some countries and the economic future of other countries seems to be bright, the contribution of transition to the social issues, widening gap between the rich and the poor, poverty, child care, medical facilities and HIV/AIDS would be the future challenges to the world.

These problems would be paramount in lower-income countries in general and lower-income African countries in particular unless certain measures are taken immediately, would affect the cause of humanity hindering economic benefits of transition to the market economy.

(E) POLITICAL ENVIRONMENT

Political Ideologies

Political ideology is the body of complex ideas, theories and objectives that constitute a socio-political program. Most of the countries at present are political pluralistic as different people have various ideologies. Political ideologies of the people in the same country vary widely due to the variations in culture, ethnic groups, tribal groups, community groups, religious groups and economic groups. These variations influence the people to form different political parties. Managers in multi-political party environment find it difficult to articulate the company's interest and formulae its mission in order to balance them with the ideology of the political parties.

The political system of the country should hold, all the groups with different ideologies, together. Otherwise, it leads to splits of the countries like India and Pakistan in 1947, the former U.S.S.R., Yugoslavia, Ethiopia and Eritrea, Indonesia and East Timor etc. Thus, differences in political ideologies change the national boundaries. International business managers should understand these differences and existence of various groups in the host countries in order to foresee the possible political tensions and instabilities.

Democracy

The ideology of pure democracy aims that all citizens should be equal politically and legally should enjoy freedom and participate in the political process. Pure democracy is not practically implemented and as such countries practise different forms of representative democracy, where citizens elect representatives to make decision on their behalf. Characteristics of contemporary and representative democracy include:

- Freedom of opinion, expression, press and freedom to organise.
- Freedom of electing the representative by voting.
- Limited terms for elected officials.
- An independent and fair judicial system with higher regard for individual rights and property.
- A non-political bureaucracy and defence infrastructure.

- An accessibility to the decision-making process.

Political Rights and Civil Liberties

Political and Civil Liberties help for evaluating the freedom of citizen.

The major indicators of political rights are:

- Conduct of elections fairly and competitively.
- Power and ability of the voters in casting their votes in the process of electing their representatives.
- People's ability in forming political parties and groups.
- Existence of safeguards for monitories' rights

The major indicators for civil liberties include:

- Degree of freedom of the press.
- Equality for all individuals under the Law.
- Degree of personal social freedom.
- Freedom from extreme indifference of government and corruption.

Countries *high in political rights* and civil liberties are free and vice-versa is true (not free) in case of countries *low in political rights* and civil liberties. Countries moderate in political rights and civil liberties are termed as '*partly free countries*'. Some of the free countries include: Australia, Bahamas, Canada, Japan and South Korea. Partly free countries include: Brazil, Ethiopia, Malaysia and Russia. Not free countries include: China, Egypt, Saudi Arabia and North Korea. Free and partly free countries attract the international business firms into their countries.

Democracies vary not only in the citizens participation in decision-making but also in the degree of centralization of control. Canada and the USA are highly decentralised as they delegate significant political authority to provincial governments. International business firms, in these countries are in a complex situation with regard to following federal laws and provincial laws. Political and legal systems in France, Japan and India are highly centralized and as such multinational companies enjoy easy system to deal in such countries.

The advantages and conveniences of democracy changed the trend toward democracy. As such the former totalitarian countries like Indonesia and the republics of the former USSR adopt democracy. But these democracies are fragile and unstable. Even the mature democracies have a problem as confidence in politicians and government has been on a declining trend, due to corruption, indifference towards people and maximising personal interest rather than national interest by the politicians. This type of declining trend complicates the relations of business with the government.

Totalitarianism

Totalitarianism is opposite to democracy and it is of two types *viz.*, theocratic and secular. Religious leaders also assume the roles of political leaders and rules the country in theocratic totalitarianism, as is the case in Iran. One or a group of leaders or a single political party without aligning with any religions assumes the power and rule the country with military force under secular totalitarianism. In the case of Cambodia, Afghanistan before Taliban rules and Iraq under Saddam Hussein rule. Totalitarianism is also categorised as fascism, authoritarianism and communism. Fascism and authoritarianism are non-existent at present. Communism is also viewed as secular totalitarianism where political and economic systems virtually go together. Many former communist countries like Russia, Sweden and Estonia moved towards different degrees of capitalism and democracy. However, China, Vietnam and North Korea continue to be communist countries.

However, political and economic uncertainty prevails in those countries that shift from communism to capitalism and democracy due to their transition. These uncertainties cause problems to international business firms.

Political environmental factors also influence the operations of international business firms enormously *(Fig. 2.2)*.

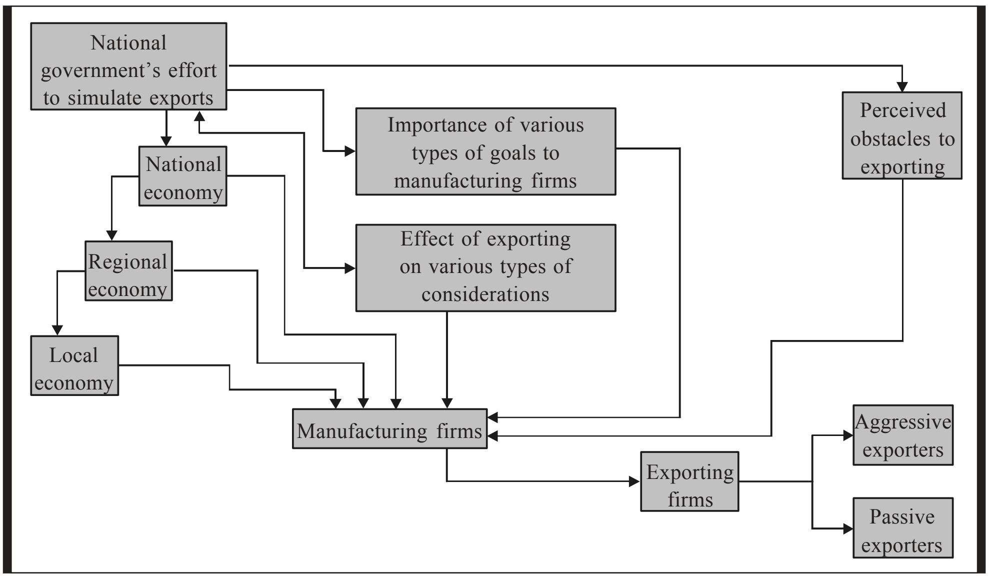

Fig. 2.2 : Government Policies to Stimulate Exports

Source: G. Tesar and J.S. Tarleton (1983), 'Stimulation of Manufacturing Firms as Part of National Export Policy', in *Export Promotion: The Public and Private Sector Interaction*, ed. M.R. Czinkota, Prague, p. 26.

The influence of the political system of a country influences the business from multi-angles, *viz.,* deciding, promoting, fostering, encouraging, sheltering, directing and controlling the business activities. *(See Box 2.13)*. The success and growth of international business depend upon the stable, dynamic, honest, people participative, secured political system in a country.

Countries with stable political system enjoyed successful business operations. The USA is the best example of political stability and dynamism. Hence, business people prefer to locate their business operations in the USA. According to John

Kenneth Galbraith, no country with a stable and honest Government has not had a reasonably satisfactory state of economic progress." The Government, in addition to being stable should also be efficient. Tanzania had a stable government during 1965 and 1985 with Mr. Nyerere as the head of the Government. He resigned in 1985 leaving a near-ruined country behind him. Zaire had similar experience with Mr. Mobutu and Zambia with Mr. Kenneth Kaunda.

BOX 2.13 POLITICS AND ECONOMICS MIX

LTV, a bankrupt U.S. defense contractor which has operated under bankruptcy court protection for six years, had to sell its missile and aircraft business. The Carlyle Group and Thomson (58 per cent owned by the French government) submitted a bid of $ 450 million which was accepted by the bankruptcy judge. However, a storm of controversy ensued. The critics and media were quite upset. First, they did not like the idea of foreign companies buying U.S. properties. Second, this particular instance was worse because it had to do with the purchase of a large U.S. defense contractor developing top-of-the-line military technology. Third, a foreign government-owned company was a buyer. Finally, the fact that the government in question was France did not help the matter since France has always been willing to sell arms to almost anyone.

Based strictly on the economic perspective, Thomson's bid made sense and should benefit both Thomson and LTV. However, because of the U.S. government's intense opposition, Thomson had to withdraw its takeover offer.

Source: "No Sale," *San Jose Mercury News,* 14 June, 1992; "Thomson Drops Bid for LTV Division," *San Jose Mercury News*, 7 July, 1992; and "French Firm Drops Pursuit of LTV Unit," *The Wall Street Journal*, 29 July, 1992.

John Kenneth Galbraith argues that, in all the advanced countries, "the early emphasis was not on capital investment but on political and then on cultural development. In the USA, West Europe and more recently in Japan, a secure political context was stressed in both thought and action on economic development; it was considered the first requisite for economic progress."

In addition to the stable and dynamic governments, the political environment includes the policies and characteristics of political parties, the nature of the constitution and government system.

Some countries do not differ from other countries regarding the philosophies of the political parties, some other countries differ radically. Some countries are highly bureaucratic in decision-making regarding foreign investment, technology imports etc., while some other countries have simple and quick decision-making mechanisms with their democratic approach.

The characteristics of bureaucratic and communistic countries include:

- Limitations, controls and curbs on private enterprises.
- Rule of the trade is state trading and counter trading.
- Many restrictions on imports and foreign capital both inflow and outflow.
- Restrictions on international/multinational corporations.

It does not mean that communist countries do not allow multinational corporations. In fact, the former USSR allowed the Pepsi when India did not allow it to enter. *Similarly,* even non-communistic countries, encouraged public sector companies. This is more so in most of the developing countries including India, before 1991. Even today India reserved nine strategic industries exclusively for public sector. Even the USA has public sector organisations. As discussed in economic environment, there are command sectors in market economies and market sectors in communistic countries.

The trend has changed even in communistic countries. They have been progressively shifting towards liberalisation, privatisation and globalisation (LPG). As many as 8,500 public sector enterprises were brought under the umbrella of private sector in over 80 countries up to 1991. The erstwhile communist countries including the former USSR countries, and China are proceeding in the direction from Marx to the Market.

The political philosophy of the developing countries shifted from self-sufficiency to self-reliance. As such they compete among themselves to woo foreign capital, technology and managerial expertise.

The political philosophy of most of the governments seems to be broadly one of convergence. However, they differ widely in imposing restrictions and regulations, scope, trade policies, procedures, taxes, custom duties, incentive systems etc.

Political Relations and International Business

Political friendship/friendly diplomatic relations result in the growth of bilateral or multilateral trade. *For example,* the friendly diplomatic relations between India and the former USSR helped not only the Indian companies but also the MNCs operating in India to have close business linkages with the former USSR. *Similarly,* the friendly diplomatic relations between Pakistan and the USA helped Pakistan companies to have close business linkages with the USA.

Hostilities between countries affect the international business among the companies of these countries. Arab countries did not prefer to carry on business with the business firms of Israel. These countries prefered business relations with those countries which boycotted the business with Israel. In fact, Arab countries insisted the companies to produce Israel boycott certificate. Hence, countervailing laws were adopted in the USA to prevent the US companies from complying with this boycott.

In the USA, firms follow a policy of 'maintenance of arm's length' with the competing firms. But in other countries, particularly in Europe and India, they come to an agreement among themselves regarding price, product design, division of markets etc. This difference is mostly due to the fact that, the US market is large enough to accommodate any number of firms to operate independent of competing firms. But the size of the European countries is very small and the firms cannot enjoy large scale economies. Therefore, European firms, divide the market among themselves either in terms of products, geographical areas or customers in order to have large scale economies.

Types of Political Systems: Appraisal of political systems helps us in having an idea of political systems and their impact on international business. Governments may be parliamentary (open) or absolutist (closed).

- In parliamentary governments people are consulted and are allowed to participate in decision-making on all important issues.
- Under absolutist government, the ruling government dictates government policies, rules and regulations on all citizens without considering the latter's needs or views. Though Saudi Arabia and North Korea claim that they are parliamentary type political systems, they do not allow the people to express their voice. Hence, they are classified as monarchies and dictatorships. Business in these countries is completely based on government policies rather than the people's needs.

Government may also be classified as two-party system, multi-party, single-party and one-party dominated.

- ***Two-party system:*** Two major parties take turn of controlling the government under the two-party system. The USA and the UK are the examples of two-party system. The Republican party in the USA (is viewed as) represents the business interest and the Democratic party represents the Labour.
- ***Multi-party system:*** There would be many parties and no party is strong to gain the control of the Government in a multi-party system. Germany, France, Israel, India (during 1996-2000) and Poland are examples of multi-party systems.
- ***Single-party system:*** In this system only one dominant party almost gets the opportunity to control the Government, though several parties exist. Egypt is the best example of this. Even in India, Congress party mostly ruled the country until 1997. Thus, a single- party rules the Government during the early stages of development.
- ***One-party dominated system:*** In this system, though there are more than one party, the dominant party rules the government and it does not allow any opposition party to come up. The former USSR, Cuba, Libya are examples of this system.

Level of Economic Development and Political Stability: South Africa and Italy are economically developed countries. South Africa has been facing internal and external problems and Italy has been facing labour problems and internal dissension. Vietnam is politically stable but economically developing country. This is due to varied regional, ethnic, language, religious issues/problems.

Political Risks: International business firms face political risks as and when there are changes in Government policies and/or changes in political parties in power.

Risks are based on the host government's actions like confiscation, expropriation, nationalisation, domestication and creeping expropriation.

- ***Confiscation:*** The process of nationalisation of a property without compensation is called confiscation. Chinese government's seizure of US property in 1949 when Chinese communist party took power is an example of confiscation.
- ***Expropriation:*** Expropriation is the process of nationalisation of a property with compensation. Indian Government nationalised commercial banks with compensation in July 1969.
- ***Nationalisation:*** Nationalisation is the process of shifting the ownership of private property from private individuals or institution to the Government. Burma nationalised entire foreign trade. Poland and Czech communists nationalised 100 per cent of their economy.
- ***Domestication:*** In domestication, foreign business firms relinquish control and ownership in favour of domestic investors either partly or fully. *For example,* Indian Leaf Tobacco Development Company Ltd., in India, Pepsi, General Motors and Barclays Bank in South Africa.
- ***General Instability Risk:*** These risks are due to social, political, religious unrest in the host country like the recent coup in Fiji and problems due to Muslim rebels in Philippines.
- ***Operation Risk:*** These risks are due to the imposition of controls on the foreign business operation (like production levels, marketing, finance and human resource) by the host Government.

Indicators of Political Instability

Political instability can be viewed from the social unrest, attitudes of nationals and policies of host governments.

- ***Corruption:*** *Corruption and bribery became acute and prevalent not only among bureaucrats but also among politicians during the early stage of political instability.*
- ***Social Unrest:*** Social unrest is caused by clashes between or among community groups, religious groups and ethnic groups. *For example,* Christian-Muslim conflict in Lebanon, Hindu-Muslim conflict in India, white-black conflict in the USA, the civil war between Serbs and Croats in 1991 in Yugoslavia, ethnic conflict between Christians in Armenia and Muslims in neighbouring Azerbaijan and social unrest in Kenya in 2007. *(See Box 2.14)*
- ***Attitudes of Nationals:*** The negative attitude of nationals towards foreign business and foreigners is a greater risk. These negative attitudes include exploitation, colonialism, repatriation, employment to foreigners etc.

BOX 2.14 PAKISTAN INSTABILITY POSES FRESH INVESTMENT RISKS

Pakistan's brief period as a destination for adventurous investors seems over for now, as the killing of opposition leader Benazir Bhutto brings fresh instability to an already volatile nuclear-armed nation. Bhutto was assassinated ahead of Jan. 8, 2008 elections that were seen ushering in democracy after a decade of military rule and promoting policies that — vitally for investors - would include a commitment to stamp out Islamist militants in areas bordering Afghanistan.

For the past couple of years, Pakistan has lured growing amounts of foreign cash - the Karachi stock market is up 50 percent year-to-date, making it one of Asia's top performing indices. While less than 10 percent of this $70 billion-plus market is so far held by foreigners, flows have been rising especially from the oil-rich Middle East, as the attraction of a fast growing economy outweighed the rising political risks. Foreign direct investment too has been on the up.

Part of this is due to President Pervez Musharraf's liberal economic policies and the semblance of stability that his firm military rule brought. Secondly, Pakistan has been lifted by the same tide that buoyed most emerging markets throughout 2006 and 2007.

But after the assassination of Benazir Bhutto, it is the worst possible scenario for foreign investment. Pakistan's share and currency markets, closed for three days. But foreigners have been hedging their exposure to Pakistan, with the cost of buying five-year protection via credit default swaps rising some 100 basis points since Bhutto's assassination.

The yield on Pakistan's 2017 dollar bond is now almost 600 bps over U.S. Treasuries, compared to 400 bps last week and the 250 bps premium at which it was issued in May. One result, may be not unwelcome to foreign and domestic investors in the near term, is that military or emergency rule is reimposed, allowing the new army chief powers to stamp out militant training camps. The alternative - a political vacuum caused by weak government - could be filled by radical Islamists, many fear.

Ahsan Chishty, economist at Standard Chartered in Karachi, says all hinges on how effectively order can be restored. The central bank has over $15.6 billion in its coffers to deal with weakness in the rupee - up from $12.7 billion in January 2007. Chishty expects $3 billion in FDI in the next six months.

With the political instability and ex-prime minister Nawaz Sharif, and his party boycotting the elections, the fresh investments in Pakistan are looking dull.

Source: Adapted from *The International Business Times*, December, 31, 2007

- ***Policies of the Host Government :*** Host Government's policies affect the operation of international business firms directly and internally or externally. *For example,* Janata Government in India asked Coca-Cola to leave the country in 1977 due to the policy of discouraging the multinationals. The dispute between Chile and Argentina, made Argentina to restrict exports (including the foreign companies operating in the country like General Motors, Peugeot and Renault) to Chile. The Enron Corporation's experience is another example. *Exhibit 2.4* presents the framework of political risks.

How to Minimise Political Risks?

Political risks cannot be completely eliminated. However, they can be minimised by contributing to the change of the attitudes of the people and Government of the host country like stimulation of the host country's economy, employment of nationals, sharing ownership, being civic minded, political neutrality, behind-the-scenes lobby, observation of political mood and reduction of exposure.

Stimulation of the Local Economy: The foreign company can stimulate the economic development of the host country by investing in their priority areas / portfolios. Further, the foreign company may encourage the local companies by purchasing the raw materials and other inputs from the latter, assist the local companies in technological aspects, using the local companies as ancillary units etc. *For example,* IBM is the foreign company allowed to sell switchboards in France.

Similarly, the foreign company can stimulate the host economy by being export oriented. *For example,* ATST entered France with an agreement with Gencrale de Electricite of France to produce digital switches and export to the USA.

Employment of Nationals: Mostly foreign companies feel that the people of developing countries are lazy, unintelligent, unmotivated, and less educated. As such foreign companies hire people from advanced countries and do not employ the local people.

Multinational companies can minimise political risks by employing, developing and promoting the local people *(See Box 2.15).*

BOX 2.15 MNCs REDUCE POLITICAL RISK BY EMPLOYING LOCAL PEOPLE

Originally MNCs used to employ the managers and skilled personnel of the home country. A reverse process is now underway. Talented managers and technocrats are now being lured to serve the MNCs and TNCs, and their collaborators across the globe. The separate concessions and incentives to attract foreign capital and the introduction of the labour, displaying technologies and management are indeed prescriptions for the deindustrialization of India even as capital intensive business enclaves are transferred to the control of TNCs.

The process of privatisation and globalisation that is being pushed forward will not provide royal road for MNCs to enter into different countries due to political risks. The best example in this direction is Enron Corporation in Maharashtra. In other words, MNCs are still bearing the political risks even today. As such, it is criticised that the MNCs in India, in order to reduce the political risks started employing people from India.

This is the case not only with India but also with the other developing countries. *For example*, the Kenegen Construction Company of South Korea started employing the locals in Eritrea, Ethiopia, Sudan, Egypt etc. Further, the American MNCs employ the local male as well as female employees of Saudi Arabia despite a number of cultural constraints. Similarly, the European MNCs also started providing employment opportunities to the local people in a number of Arabian countries like Oman, United Arab Emirates, Bahrain, Kuwait etc. Thus, the MNCs of various countries employ local people in order to reduce political risks.

Source : Adapted from *Monthly Commentary.*

Sharing Ownership: If the multinational company owns the entire capital by itself, it magnifies political risks. Hence, it is suggested that the foreign company should allow the domestic investors to invest and share the ownership by converting the company into a public limited company. In fact, some countries have imposed a condition that the foreign companies can enter the domestic country only with the participation of local investors. Eritrea is an example in this case. Ownership can be shared through joint ventures. Ford chose to merge its automobile operations in South Africa with Anglo American by reducing its share to a minority position of 40 per cent.

Being Civic Minded: US based MNCs sometimes encounter the 'Ugly American' label abroad. The MNCs in addition to doing business in foreign countries, they should also be good corporate citizens there. MNCs may help the foreign countries in different ways like constructing schools, hospitals, roads, water reservoirs etc. Du Pont supplied 1.4 million water jug filters to eight African countries. H.J. Heinz spent US $ 94,000 to fund infant nutrition studies in China. IBM donated computer equipment and expertise worth $ 60,000 to Costa Rica.

Political Neutrality: It is criticised that the MNCs actively involve in political affairs of developing countries. It is suggested that the MNCs should not involve in political affairs or disputes among the local groups of the host countries from the point of view of long-run interests. Brazilian companies *for example,* do not involve in the political activities of Central American countries.

Behind-the-Scenes Lobby: Firms attempt to influence political decisions. Mobil corporation issued newspaper advertisements urging US to sell missiles to Saudi Arabia. Pizza Hut came to China's rescue when the US mushroom industry asked for a quota against imports from China.

Legal Environment

Laws of the land directly affect the international business wherever they operate. Therefore, international business managers should be aware of the legal systems and the laws that are in-force in various foreign countries in addition to their home country as well as host country. Different forms of laws like the common law, civil laws, contract laws and theoretical laws and the degree of independence of the judiciary system vary from country to country. However, the countries in transition from communism to market economy, mixed economy to market-economy and different types of totalitarianism to democracy and capitalism may not have perfect business laws. Therefore, international business managers should perform their activities cautiously.

Kinds of Legal Systems

Legal systems are generally classified into the common law, civil laws, contract laws and theoretical laws.

Common Law: Traditions, customs, culture, precedent and usage are the bases for common law. Courts interpret the law according to the situations and incidents. These laws are in force in various countries *viz.,* the USA, the UK and Hong Kong.

Civil Law: Detailed set of laws which make-up a code is the basis for civil laws. Civil law is based on how the law is applied to facts. Contracts should be in detail in those countries where common law is in practice, whereas contracts are in shorter form and less specific in those countries where civil laws are in force as the issues that the common law could cover are already covered by civil codes. Countries like France, Germany and Japan follow civil laws. International business managers should understand the type of law that a country is following before entering the market.

Theocratic Law

Theocratic law is based on religious precepts like the Islamic law and the Hindu law. The Islamic law is mostly found in Muslim countries and is based on:

- The Holy Koran
- The *Sannah* or decision and sayings of the prophet *Mohammed*
- The writings of Islamic Scholars, who derive rules by analogy from the principles established in the Holy Koran and the *Sannah*
- The consensus of Muslim countries' legal communities.

The Islamic law is unchanged as it is based on the Holy Koran. Islamic law is more a moral rather than commercial law. Therefore, some Muslim countries developed their legal systems with a blend of Islamic legal system and the common law or civil law. According to Islamic law, banks cannot charge interest, but they can charge a fee in the form of profit sharing with either the depositor or borrower, as the case may be.

Property Rights

Property is a resource owned by an individual or group of individuals or business firm/s. Property rights refer to the bundle of legal rights to use the resource or allowing others to make use of it mostly for a price. Property rights are violated indifferent degrees in different countries, though the laws are enacted to protect them. This is due to the non-enforcement of laws in some countries. Methods of violation of property rights include: private action, public action and corruption.

Private Action: Attempts and actions of private individuals or groups relating to theft, blackmail and piracy are referred to as *private action*. Business people were forced to pay a fee to 'Russian Mafia' during the post-communist era due to the latter's blackmail. Mafia is the phenomenon of not only Russia, but also most other parts of the world including the U.S.A., and Japan. Mafia in Japan is known as *Yukusa*.

Public Action: Collecting income by politicians and Government officials from the holder of the legal titles of property rights is referred to as *public action*.

Public action can take place in various forms including levying higher tax rates, higher licensing fee, higher fee for permits from property holders taking assets into state ownership without paying compensation, demanding bribes and corruption or issuing licences and for operating in the country or granting a location and the like.

Bribery and corruption are quite common in several countries, but with varying degrees. Rule of the law in some countries keeps corruption at minimum by punishments, while corruption is endemic in some other countries due to the inefficient enforcement of laws and rules. Transparency International ranked the corruption levels of the countries in 2000 and indicated that Finland, is corruption free country, Canada, Singapore, the U.K. and Switzerland are relatively very low corruption countries while Nigeria, Indonesia, Russia and China are most corrupted countries in the order.

Protection of Intellectual Property

The output of intellectual activity like an invention, a screenplay, computer software, chemical formula for a new drug and the like. Patents, copyrights and trademarks establish ownership rights over intellectual property rights. A patent provides exclusive rights to the inventor of a new product or process for a particular period to produce and market the product/process. Copyrights provide exclusive rights to the authors, publishers, composers and the like to publish and market their works. Trademarks are designs, icons and names used by the producers and marketers to differentiate their products/services form those of others. These trademarks are officially registered and become exclusive rights of the manufacturers who registered them. Protecting intellectual property rights across the globe is a problem due to the enormity of the task, cultural differences across the globe and limitations of various governments in enforcing the laws. World Trade Organization is enforcing the intellectual property regulations. Governments in various member countries of the World Trade Organization have been either formulating new laws or amending the existing laws in order to protect the intellectual property rights.

Product Safety and Product Liability

Products must adhere to certain safety standards as prescribed by product safety laws. Firm and its executives hold responsibility under product liability when injury, death or damage is caused by usage or consumption of a product. These laws and standards are more comprehensive in the USA compared to other countries. Differences in coverage of these laws among the countries result in variation in competitive advantage as well as non-uniformity of ethical standards to and among countries. Thus the countries with less comprehensive product safety and product liability laws provide an opportunity to business to reduce its cost and possess more competitive advantage than their counterparts in those countries, where the laws are more comprehensive.

Labour Laws: Labour legislations are enacted in various countries, mostly based on the resolutions of the International Labour Organization. These legislations prescribe the minimum wages, trade union activities, employee–employer relations, collective negotiations, recruitment and employment practices, stipulations regarding working conditions, employee benefits, regulations and modalities of prevention and settlement of industrial disputes. However, MNCs forced most of the governments to play an indifferent role with respect to implementation of labour laws. MNCs enter those countries where the cost of human resource is less in order to acquire competitive advantage through less cost of human resources. *(See Box 2.16*).

BOX 2.16 **NIKE IN VIETNAM: FAILURE OF IMPLEMENTATION OF LABOUR LAWS**

Nike sub-contracted its manufacturing operations in Vietnam. The operations employed 25,000 employees and most of them are young women. Their wages were as low as $40 a month and the working conditions in the factories were quite inferior. Nike's practices were widely criticised by media. Consequently, Nike hired Andrew Young – former US Ambassador to UN to enquire into the working conditions of employees and present a report. Mr. Young did not conduct detailed study but reported that Nike was doing a good job in treating the workers. Mr. Young was criticised widely for his improper reporting. Then Nike joined a task force including industry leaders, human rights groups and labour leaders that resulted in reaching an accord for payment of local minimum wages in foreign factories and establishment of Fair Labour Association – an independent association to monitor the wages and working conditions. Later, Nike announced a number of initiatives and incentives to employees working with its subcontractors. It was widely criticised that the Fair Labour Association was not an independent body and the labour practices in Nike were unfair even during 2001.

Source: Adapted from *"Right Group says Nike isn't Fulfilling Promises",* - Wall Street Journal, May 16, 2001

POINTS TO BE REMEMBERED

- Environment provides opportunities to business and sometimes it poses challenges. Global business firms formulate business strategies to exploit the opportunities offered by the environment.
- Social and cultural factors, in fact, create customers and business.
- Culture is responsible for the success and failure of products and services.
- Culture is prescriptive, socially shared, learned, subjective and enduring.
- Technology is application of knowledge which redefine the boundaries of global business.
- There are three types of economic systems, *viz.,* capitalistic, communistic and mixed. The economic conditions vary from one system to another system.
- Ability of the people to buy products and services is low in low income countries compared to those of high income countries.

- Political stability mostly helps in the growth of business. But there are certain exceptions to this generalisation. In fact, business developed at a fast rate in certain politically instable countries like Italy and Germany.

KEY WORDS

- Social Environment
- Cultural Environment
- Cultural Attitudes
- Cross-cultural Communication
- Superstition
- Population Location
- Political Environment
- Political Risks
- Technological Environment
- Economic Environment
- Economic Systems
- Low-Income Countries
- Middle-Income Countries
- Basket Cases
- Income Location
- Civic Mind

QUESTIONS FOR DISCUSSION

1. What is business environment? Explain the different factors of international business environment.
2. What is social and cultural environment? Analyse the impact of social and cultural factors on the global business.
3. Explain the cross-cultural communication process and negotiation with suitable examples.
4. Analyse the impact of culture on the behaviour of a global consumer.
5. What is technology? Explain the role of technological changes in the global business.
6. What is economic environment? Explain different kinds of economic systems and their influence on international business.
7. How do you classify the countries as low income, middle-income and rich income countries? Do you think that the economic status of the country influences the global business?
8. Do you believe that political stability leads to business development and *vice versa*? If yes state your answer with examples.
9. What is political environment? How does it affect international business?

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Unit Three

MULTINATIONAL CORPORATIONS

CHAPTER OUTLINE

(A) DEFINITION

A multinational corporation/company is an organisation doing business in more than one country. Transnational company produces, markets, invests and operates across the world. It is integrated global enterprise which links global resources with global markets at profit. These companies have sales offices and/or manufacturing facilities in many countries. A corporation (MNC) engages in various activities like exporting, importing, manufacturing in different countries. MNCs have worldwide involvement and a global perspective in its management and decision-making,

(i) MNCs consider opportunities throughout the globe though they do the business in a few countries.

(ii) MNCs invest considerable portion of their assets internationally.

(iii) MNCs engage in international production and operate plants in a number of countries.

(iv) MNCs take managerial decisions based on a global perspective. The international operations are integrated into the corporations' overall business.

MNCs are huge industrial/business organisations. They extend their industrial/marketing operations through a network of branches or their majority owned foreign affiliates. MNCs produce the products in one or a few countries and sell them in most of the countries. Transnational corporations produce the products in each country based on the specific needs of the customers of that country and market these. A transnational corporation mostly uses the inputs of the host country where it operates unlike a multinational company.

Large corporations having investment and business in a number of countries, known by various names such as Multinational Corporations, International Corporations and global corporations (or firms, companies or enterprises) have become a very powerful driving force in the world's economy.

As ILO Report Observes, "the essential nature of the multinational enterprises lies in the fact that its managerial headquarters are located in one country (referred for convenience as the 'home country') while the enterprise carries out operations in a number of other countries as well ('host-countries,'). *Obviously,* what is meant is a corporation that controls production facilities in more than one country, such facilities having been acquired through the process of foreign-direct investment. Firms that participate in international business, however large they may be, solely by exporting or by hunting technology are not Multinational enterprises."

(B) DEFINITIONS AND CONCEPTS

- **Global Corporation:** Global Corporation produces in home country or in a single country and focuses on marketing these products globally or produces the products globally and focuses on marketing these products domestically. *For example*, a USA company produces globally in various countries and market in the domestic market *i.e.,* the USA market. Thus, certain operations are centralized and other operations are decentralized. Global corporations implement parent company strategies wherever they operate, rather than formulating strategies separately for each market. Global corporations develop the knowledge in various countries, but its units do not share such knowledge across the globe. As such the overseas units retain the knowledge developed.
- **International Corporation:** International Corporation (IC) conducts the operations (exporting, producing etc.) in one or more foreign countries, but with domestic orientation. This company believes that the practices adopted in domestic business, the people and products of domestic business are superior to those of other countries. This company extends the domestic product, domestic price, promotion and other business practices to the foreign markets.
- **Multinational Corporation:** Multinational Corporation responds to the specific needs of the different country markets regarding product, price and promotion. Thus MNC operates in more than one country, but operates like a domestic company of the country concerned.
- **Transnational Corporation (TNC):** Transnational Corporation produces, markets, invests and operates across the world. *(See Table 3.1)*.

However, the terms Multinational Corporation (MNC) Global Corporation (GC) and Transnational Corporation (TNC) are used interchangeably in this chapter.

TABLE 3.1 CHARACTERISTICS OF DIFFERENT ORGANISATIONAL MODELS

Organisational characteristics	*Multinational*	*Global*	*International*	*Transnational*
Configuration of assets and capabilities	Decentralised and nationally self-sufficient	Centralised and globally scaled	Sources of core competencies centralised, others decentralised	Dispersed, interdependent and specialised
Roles of overseas operations	Sensing and exploiting local opportunities	Implementing parent company strategies	Adapting and leveraging parent company strategies	Differentiated contributions by national units to integrated worldwide operations.
Development and diffusion of knowledge	Knowledge developed and retained within each unit	Knowledge developed and retained at the centre	Knowledge deve-loped at the centre and transferred to overseas units.	Knowledge developed jointly and shared worldwide

Source : Christopher A. Bartlett and Sumantra Ghoshal, Managing Across Borders*, Boston, Harvard Business School Press, 1998.*

Why Companies become Multinational Companies

Domestic companies become multinational companies (MNCs) for a number of reasons. They include:

- To protect themselves from the uncertainties and risks of business cycles, political policies and social uncertainties of the domestic country. Expanding the operations to a number of foreign countries can offset the negative consequences of domestic effects.
- To tap the growing global market for various goods and services. Many MNCs targeted India and China during the 21st century because of their large population and increasing per capita income. Some MNCs targeted Japanese and European markets in view of their rich and sophisticated markets.
- **To increase market share:** Firms become MNCs in order to increase their market share by expanding their operations to a number of countries.
- **To reduce costs:** Companies become MNCs by locating their manufacturing facilities close to the foreign customers. This in turn reduces cost of transportation, warehousing etc.
- **To overcome tariffs:** Many countries charge tariffs if the companies export goods from other countries. In contrast, companies need not pay tariffs, if they locate their manufacturing facilities in foreign countries. Therefore, companies become MNCs by locating their manufacturing facilities in foreign countries.

Companies exporting goods and services to EEC countries are subject to tariffs. Companies producing goods within EEC countries can market them in any of these countries without paying tariffs. The same is the case with NAFTA countries *viz.,* the USA, Canada and Mexico.

- **To have technological advantage:** Companies become MNCs in order to take advantage of technological expertise by producing goods directly in foreign countries rather than through licensing.

Operating Characteristics of MNCs

The characteristics of MNCs depend upon the environment in which they operate. MNCs have two concerns *viz.,* the home country/headquarters environment and the host country environment where they carry-out business. The characteristics of MNCs include :

- The subsidiaries of MNCs should respond to the significant environmental forces of both home country and host country. Sometimes the same environmental forces influence the MNCs both at the home and host countries. *For example,* General Motors of the US faces competition from Ford, Honda, Volvo, Volkswagen, Chrysler both in the USA and Europe.
- MNCs draw more or less the same resources both at the home country and host country. These resources include financial resources, human resources, material resources, information, patents, trademarks etc.
- The subsidiaries and headquarters of MNCs are linked by a common vision and mission. However, each subsidiary of MNCs formulate their strategies.
- MNCs prefer to relocate their operations in various countries based on low wage rates, low transportation costs, closeness to suppliers of raw materials and customers and threats posed by the other country governments.

(C) FACTORS CONTRIBUTED FOR THE GROWTH OF MNCs

MNCs exercise massive control over world economy. Several factors contributed for the growth of MNCs. The important among them are:

(i) Expansion of Market Territory: The growth of the various economies along with the growth of GDP, and per capita income resulted in the rise in the living standards. These factors contributed towards the expansion of market territory. Added to this, the large operations of the MNCs build the image, which contributes to the expansion of market territory.

(ii) Market Superiorities: MNCs enjoy a number of market superiorities over the domestic companies. They include: *(a)* Availability of more reliable and up-to-date data and information. *(b)* they enjoy market reputation, *(c)* They face less difficulties in marketing the products. *(d)* They adopt more effective advertising and sales promotion techniques. *(e)* They enjoy quick transportation and warehousing facilities. *(Table 3.2 presents the world's major corporations in 2007).*

TABLE 3.2 THE WORLD'S MAJOR MNCs

Rank	*Company*	*Revenues ($ millions)*	*Profits ($ millions)*
1	Wal-Mart Stores	351,139.0	11,284.0
2	Exxon Mobil	347,254.0	39,500.0
3	General Motors	207,349.0	-1,978.0
4	Chevron	200,567.0	17,138.0
5	ConocoPhillips	172,451.0	15,550.0
6	General Electric	168,307.0	20,829.0
7	Ford Motor	160,126.0	-12,613.0
8	Citigroup	146,777.0	21,538.0
9	Bank of America Corp.	117,017.0	21,133.0
10	American Intl. Group	113,194.0	14,048.0
11	J.P. Morgan Chase & Co.	99,973.0	14,444.0
12	Berkshire Hathaway	98,539.0	11,015.0
13	Verizon Communications	93,221.0	6,197.0
14	Hewlett-Packard	91,658.0	6,198.0
15	Intl. Business Machines	91,424.0	9,492.0
16	Valero Energy	91,051.0	5,463.0
17	Home Depot	90,837.0	5,761.0
18	McKesson	88,050.0	751.0
19	Cardinal Health	81,895.1	1,000.1
20	Morgan Stanley	76,688.0	7,472.0
21	UnitedHealth Group	71,542.0	4,159.0
22	Merrill Lynch	70,591.0	7,499.0
23	Altria Group	70,324.0	12,022.0
24	Goldman Sachs Group	69,353.0	9,537.0
25	Procter & Gamble	68,222.0	8,684.0
26	Kroger	66,111.2	1,114.9
27	AT&T	63,055.0	7,356.0
28	Boeing	61,530.0	2,215.0
29	AmerisourceBergen	61,203.1	467.7
30	Marathon Oil	60,643.0	5,234.0
31	State Farm Insurance Cos	60,528.0	5,315.5
32	Costco Wholesale	60,151.2	1,103.2
33	Target	59,490.0	2,787.0
34	Dell	57,095.0	2,614.0
35	Wellpoint	56,953.0	3,094.9

36	Johnson & Johnson	53,324.0	11,053.0
37	MetLife	53,275.0	6,293.0
38	Sears Holdings	53,012.0	1,490.0
39	Pfizer	52,415.0	19,337.0
40	Dow Chemical	49,124.0	3,724.0
41	Wells Fargo	47,979.0	8,482.0
42	United Technologies	47,829.0	3,732.0
43	United Parcel Service	47,547.0	4,202.0
44	Walgreen	47,409.0	1,750.6
45	Lowe's	46,927.0	3,105.0
46	Wachovia Corp.	46,810.0	7,791.0
47	Lehman Brothers Holdings	46,709.0	4,007.0
48	Time Warner	44,788.0	6,552.0
49	Microsoft	44,282.0	12,599.0
50	Freddie Mac	44,002.0	2,211.0

(iii) Financial Superiorities: MNCs enjoy financial superiorities over national companies, in addition to market superiorities.

They are: *(i)* Huge financial resources at the disposal of the MNCs. These resources are used for turning the environment and circumstances in their favour. *(ii)* They can use the funds more effectively and economically as the excess funds from one country can be used to meet the requirements in other countries. *(iii)* They have easy access to external capital markets *(iv)* They can mobilise different types of resources of high quality easily, *(v)* They can have access to international banks and financial institutions.

(iv) Technological Superiorities: MNCs are allowed, if not invited by the developing countries mostly due to the technological backwardness of these countries. In fact, MNCs are rich in advanced technology. They develop the technology through continuous research and development. The rich financial and other resources of the MNCs enable them to invest on R&D and develop the advanced technology.

The developing economies regard the transfer of the technology from the MNCs as a useful account due to the following reasons:

(a) Industrialisation is in a backward state in developing countries and the resources available in developing countries are insufficient to develop the technology and thereby industrialisation.

(b) Developing countries are rich in mineral and natural resources. They are unable to exploit them fully due to paucity of financial resources and low level technology.

(c) Local manpower, materials, capital etc. cannot be optimally utilised by the developing countries on their own. Therefore, MNCs are invited by the developing countries to help them in exploiting the resources.

(d) Developing countries would be required to import raw materials, capital equipment, technology etc. on their own. This in turn needs large foreign exchange resources. Developing countries which suffer from paucity of foreign exchange resources invite MNCs in this regard.

(e) Developing countries, though they produce goods and services on their own by importing technology and materials, they fail in marketing the products due to severe competition. This inability of developing countries, forces them to invite MNCs.

(v) Product Innovation: MNCs, by virtue of their widespread operations in many countries, collect information regarding customers, tastes and preferences. Further, the MNCs with their strong R & D departments, invent new products and develop the existing products. Developing countries suffer from limitations in this regard. Therefore, they invite MNCs to their countries.

These factors do not favour all the countries in an equitable manner as various country related factors play vital role. As such, some countries dominate in developing MNCs. *Table 3.3* shows the country of origin of World's 500 largest MNCs in 2007.

TABLE 3.3 THE WORLD'S LARGEST MNCs COUNTRY WISE IN 2007

Rank	*Country*	*No. of MNCs*	*Rank*	*Country*	*No. of MNCs*
1	European Union	(163 companies)	11	Switzerland	(13)
2	United States	(162)	12	Italy	(10)
3	Japan	(67)	13	Spain	(9)
4	France	(38)	14	Australia	(8)
5	Germany	(37)	15	Taiwan	(6)
6	United Kingdom	(34)	16	India	(6)
7	China	(24)	17	Sweden	(6)
8	Canada	(16)	18	Belgium	(6)
9	The Netherlands	(16)	19	Brazil	(5)
10	South Korea	(14)			

(D) ADVANTAGES AND DISADVANTAGES OF MNCs

Multinational corporations undoubtedly, carry out business with the ultimate goal of profit- making like any other domestic business. According to *the ILO report,* "for some, the multinational companies are an invaluable dynamic force and instrument for wider distribution of capital, technology and employment; for others they are monsters which our present institutions, national or international cannot adequately control, a law to themselves with no reasonable concept, the public interest or social policy can accept". In the process of carrying out the business

MNCs directly and indirectly help both the home country and the host country as well as cause harm to both the countries. However, the degree of harm would be more to the host countries.*(See Box 3.1)*.

BOX 3.1 TIME FOR INDIA TO THROW OUT MNCs

"Water belongs to the people." "Water is not a commodity to make profit." Banners screaming such messages dot Plachimada, in Kerala's Palakkad district, with the World Water Conference underway at the sleepy, remote village.The Perumatty Panchayat, under which Plachimada village falls, has hosted the three-day conference that is discussing the world's dwindling water resources.The village has been embroiled in a legal dispute with the American soft-drink giant Coca-Cola over groundwater depletion.On Thursday, scores of activists and delegates from various foreign countries joined the farmers and tribals in a mass rally to the Coke plant at Plachimada.Raising slogans for the villagers' right to water, the demonstrators urged that Coca-Cola wind up its operations in the village. "We want drinking water. No Coke, no Pepsi," they cried.

Source: Adapted from:rediff.com

Advantages of the MNCs to the Host Country

Exhibit 3.1 presents the advantages and disadvantages of MNCs to the home country.

EXHIBIT 3.1 ADVANTAGES AND DISADVANTAGES OF MNCs TO THE HOST COUNTRIES

Advantages	*Disadvantages*
• Increases economic activity • Increases industrial activity • Increases employment and income levels • Domestic industry gets the latest technology • Domestic industry gets sophisticated management techniques • Domestic input suppliers get more business • Improves the competitive ability of domestic business due to competition • Domestic business uses outcome of MNC's R&D efforts • Advantages of foreign culture through cultural transformation • Reduction of imports and favourable effect on balance of payments • Domestic consumers have the advantage of consuming a variety of goods and services • MNCs earn foreign exchange by exporting to the neighbouring countries • Utilisation of natural resources of the host countries.	• Technology developed by the MNCs may not suit the needs of host country. • MNCs may not operate within national autonomy and sovereignty. • Monopolistic practices of MNCs may kill the domestic industry. • MNCs may adopt ethnocentric approach in staffing. • MNCs may use the natural resources of the host country indiscriminately. • A large sum of money may flow from the domestic country in the form of dividends and royalty. • MNCs normally concentrate on consumer goods but not capital goods and infrastructure in host country. • MNCs may distort the economic structure of the host countries. • MNCs may interfere in the political activities of the host countries. • MNCs normally provide the out dated technology to the host country industry. • Pollutes the environment of the host countries.

The home country can also get the benefits from the MNCs operations.

Exhibit 3.2 presents the advantages and disadvantages of MNCs to the home country.

EXHIBIT 3.2 ADVANTAGES AND DISADVANTAGES OF MNCs TO THE HOME COUNTRIES

Advantages	*Disadvantages*
• Create the demand for the home country products. • Boost up the industrial activity of the home country. • Create employment for home country people. • Earns foreign exchange for the home country and contributes for the balance of payment. • Get the benefit of foreign culture. • Produce the products required by the domestic consumers in foreign countries with foreign resources. • Saves the domestic country from environmental pollution. • Get the customers/users for the country's out-dated technology. • Optimum utilisation of natural resources and conservation the country's scarce resources like petroleum resources in the USA. • Generates and accumulate capital for home country by earning profits through business operations in host countries.	• Transfer capital to other countries and cause unfavourable balance of payments. • May not create employment opportunities to domestic people by following geocentric approach or outsourcing business operations in various countries like USA software companies outsourcing business operations in India. • May neglect the industrial development of the home country as the transnational companies follow the secular approach. • May cause erosion of the domestic culture. • May exploit the natural resources resulting in excessive exploitation of natural resources.

(E) CONTROL OVER MNCs

Different agencies in India control the MNCs. These agencies include: *(i)* the Department of Company Affairs *(ii)* the Reserve Bank of India *(iii)* the Ministry of Industrial Development and *(iv)* the Ministry of Finance. These agencies normally do not work in co-ordination. Hence, control of MNCs may not be efficient. In view of this, the Government of India imposed certain regulations to control MNCs. These include:

(i) Some industries were not allowed to import technology where the products are not essential and where domestic capacity was adequate.

(ii) The maximum rate of royalty was imposed on technology, imports for those industries which were allowed to import technology.

(iii) Import of foreign capital was allowed but sometimes they were based on administrative decisions.

(iv) Permissible period of agreement was reduced from 10 years to 5 years.

(v) Exports and other marketing restrictions were imposed.

(F) ORGANISATION STRUCTURE OF MNCs

Designing Organisational Structure

Organisations are economic and social entities in which a number of persons perform multifarious tasks in order to attain common goals. Organisations are effective instruments in that they help individuals accomplish personal objectives that they (persons) cannot achieve alone. According to Argyris, organisations are usually formed to satisfy objectives, "that can best be met collectively."

Organisation is only a means to an end. It takes certain inputs from the environment and converts them into specified outputs desired by the society. Organisation design deals with structural aspects of organisations: it aims at analysing roles and relationships so that collective effort can be explicitly organised to achieve specific ends. The design process leads to development of an organisation structure consisting of units and positions. There are relationships involving exercise of authority and exchange of information between these units and positions. Thus, organisation design may lead to the definition and description of a more or less formal structure. Organisation design is "the process of systematic and logical grouping of activities, delegation of authority and responsibility and establishing working relationships that will enable both the company and employee to realise their mutual objectives."

Steps in Designing Organisational Structure

The first step in organisation design is analysis of the present and future circumstances and environmental factors. The next stage deals with detailed planning and implementation. Organisation analysis is the basis for organisation design and is the process of defining aims, objectives, activities and structure of an enterprise. Organisation analysis includes an analysis of the following aspects:

1. External environment – economic, political, legal etc.
2. Overall aims and purpose of the enterprise – survival, growth, profit maximisation, wealth maximisation etc.
3. Objectives – specific aims or targets to be achieved.
4. Activities – assessment of work being done and what needs to be done if the company is to achieve its objectivities.
5. Decisions to be taken across horizontal and vertical dimensions.
6. Relationships – from the view point of communications.
7. Organisation structure – includes grouping of activities, span of management, management levels etc.
8. Job structure – job design, job analysis, job description, job specification etc.
9. Organisation climate – working atmosphere of the enterprise. It includes team work and co-operation, commitment, communications, creativity, conflict resolution, participation, confidence and trust.

10. Management style – includes *laissez-faire*, democratic, benevolent-autocratic.
11. Human resource – includes availability of human resources marked by skill, knowledge, commitment, aptitude etc.

Organisations of MNCs can be designed based on two options – Vertical/tall organisations and horizontal/flat organisations.

Vertical/Tall Organisations

Vertical/tall organisations refer to increase in the length of the organisation's hierarchy chain of command. The hierarchical chain of command represents the company's authority – accountability relationship between superiors and subordinates. Authority and responsibility flow from the top to the bottom through all the levels of the hierarchy. Accountability flows from the lowest level to the highest level. Employees at each level should report to their superior, who in turn should report to his boss. Thus, the activities are reported to the top. Authority is more centralised in tall organisation.

Horizontal/Flat Organisations

Horizontal/flat organisations refer to an increase in breadth of an organisation's structure.

The increasing bio-professionalisation and multi-professionalisation and wide acceptance for empowerment allowed even the large business firms to reduce the number of hierarchical levels of their organisations. Consequently, large sized firms also started adopting horizontal/flat organisation by delayering. In fact, this structure is well suited for the small size business firms.

Authority is more decentralised in relatively flat structures. Manager with broad span of control must grant more authority to his subordinates. Decisions are more likely to be made by the employees who are at the helm of affairs and more familiar with the situations and ground realities. Organisational activities are mostly performed informally.

Approaches to Organisation Structure of MNCs

There are seven approaches to structure the organisation. They are:

1. Product organisation structure,
2. Geographical organisation structure,
3. Decentralised business divisions,
4. Strategic business units, and
5. Matrix organisational structure.
6. Team organisational structure
7. Virtual organisation structure

1. Product Organisation Structure

Activities are divided on the basis of individual products, product line, service and are grouped into departments in product organisation structure. All important functions *viz.*, marketing, production, finance and human resource are contained within each department. This type of organisation structure overcomes many of the major limitations of functional organisational structure. *Fig. 3.1* presents the product organisation structure.

Advantages: *(i)* The product organisation structure is more appropriate than the functional form of organisation for firms producing multiple products. *(ii)* Co-ordination among functional areas like product design, producing, distributing, marketing is effective as all functions are performed in each department. *(iii)* Since, each department is independent, most of the decisions can be made at departmental level without involving the top management in this process. It will result in fast decisions, enhancement of organisational competency to compete in rapidly charging environment. *(iv)* Responsibility and accountability for market share, sales, profit/loss are clearly fixed. Thus, either the credit for the success or blame for the failure of a product can be clearly attributed to a particular department. This advantage cannot be present in case of functional organisation structure.

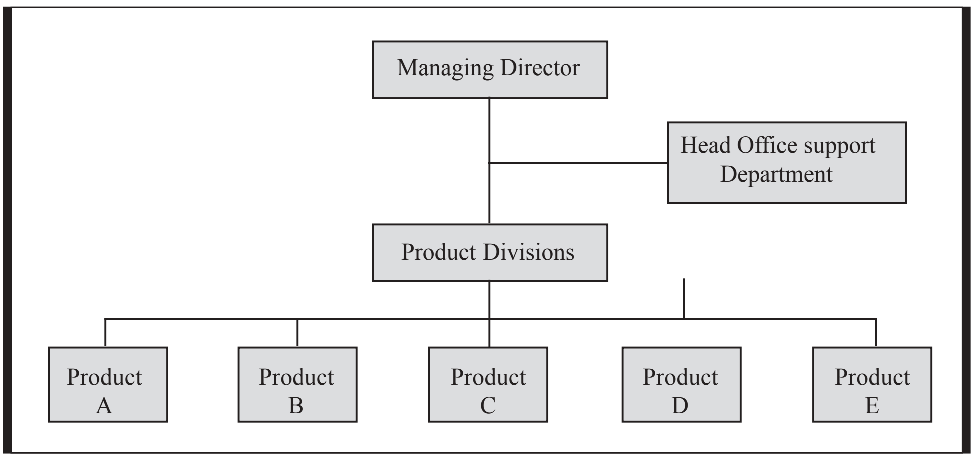


Fig. 3.1 : Product Organisational Structure

Disadvantages: Product organisational structure is also not free from limitations: *(i)* One of the major limitations is that there is unnecessary duplication of equipment and personnel among various departments. This results in loss of specialisation. *(ii)* Each department will have production, marketing, human resource, finance managers, secretarial and support staff, computers and testing equipment. As such specialised personnel and equipment cannot be procured. *(iii)* Some decisions like pay, promotion, product quality, design and pricing strategy may be inconsistent between departments. *(iv)* Inter-departmental conflicts arise regarding sharing of common resources, allocation of common and overhead expenses etc.

2. Geographical Organisation Structure

The activities or functions are grouped into departments based on the activities performed in the geographical areas/regions. Each geographical unit includes all functions required to produce and market the products in a particular geographical area. *Figure 3.2* presents a geographical organisation structure. Multinational organisations, enterprises operating in diverse geographic markets or serving an expansive geographic area are organised based on the geographic structure. This structure is also used by chain stores, power companies, restaurant chains, dairy products, banking companies, insurance companies etc.

Advantages: The advantages of this type of organisational structure are: *(i)* Products and services are better designed to the climatic and cultural needs of specific geographical regions. *(ii)* A geographical structure allows a firm to respond to the technical needs of different international area. *(iii)* Producing and distributing products in different national or global locations may give the organisation an opportunity to better serve the consumer needs of various nations. *(iv)* This organisation structure enables a company to adapt to varying legal systems. *(v)* It also allows firms pinpoint the responsibility for profits or losses.

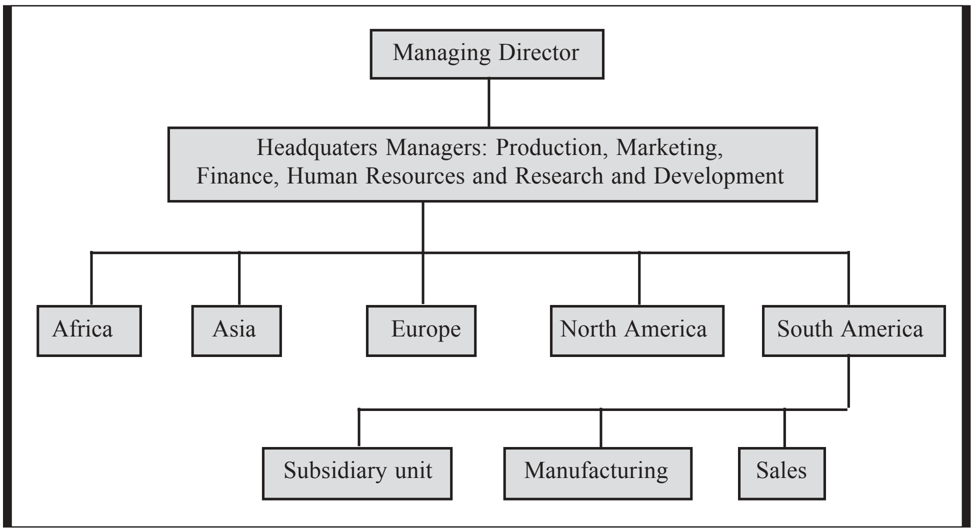


Fig. 3.2 : Geogrphical Organisation Structure

Disadvantages: This organisational structure is also not free from limitations. The limitations of this structure are similar to those of product structure. *(i)* Often more functional personnel are required. The firm cannot appoint specialists unlike in functional structure due to duplication of personnel. *(ii)* There would be duplication of equipment and facilities. *(iii)* Co-ordination of company-wide activities would be difficult. *(iv)* There would be a problem of imposing a degree of uniformity and diversity. *(v)* It is difficult to maintain consistent company image or reputation. *(vi)* This structure adds another layer of management to run geographic units. Advantages and disadvantages are presented in *Exhibit 3.3.*

EXHIBIT 3.3 STRATEGIC ADVANTAGES AND DISADVANTAGES OF GEOGRAPHICAL ORGANISATION STRUCTURE

Advantages	*Disadvantages*
• Allows tailoring of strategy to needs of each geographical market. • Delegates profit/loss responsibility to lowest strategic level. • Improves functional co-ordination within the target market. • Takes advantages of economies of local operations. • Area units make an excellent training ground for higher level general managers. • Clarifies profit/loss accountability. • Results in good functional co-ordination.	• Poses a problem of how much geographic uniformity headquarters should impose versus how much geographic diversity should be allowed. • Greater difficulty in maintaining consistent company image/reputation from area to area when area managers exercise much strategic freedom. • Adds another layer of management to run the geographic units. • Can result in duplication of staff services at headquarters and regional levels, creating a relative cost disadvantage. • Results in inconsistent decisions from one region to another region. • Results in duplication of equipment and personnel. • Encourages dysfunctional competition for resources. • Results in loss specification. • Emphasises regional rather than company goal.

3. Decentralised Business Unit Structure

Grouping activities based on product lines have been a trend among diversified companies since 1920. In a diversified firm, the basic organisational building blocks are its business units, each business is operated as a stand-along profit centre. *Figure 3.3* presents decentralised line of business type of organisational structure.

Advantages: Functional structure and geographic structure are standard organisational structures. But, in multibusiness firms, the businesses are diversified. Advantages include:*(i)* Diversification is generally managed by decentralised decision-making and delegating authority and responsibility to a manager at each business unit. *(ii)* Each business unit should be managed by an entrepreneurially oriented general manager who is delegated with authority to formulate and execute business strategies. *(iii)* Each business unit operates as a stand-alone profit centre. Each business unit is structured on the basis of either functional structure or geographic structure depending upon strategy, key activities and operating requirements.

Disadvantages: The disadvantages are : *(i)* The major problem of this type of organisation is absence of mechanism for co-ordinating related activities across business units. *(ii)* General manager in charge of each business unit functions independently. It makes co-ordination a complicated task. Therefore, corporate headquarters must devise some internal mechanism for achieving strategic co-ordination and to capture strategic benefits. Co-ordination can be achieved by developing corporate R & D department, corporate sales force, sales force of closely related businesses, merging the order processing and shipping functions of businesses with common customers and consolidating the production of related parts.

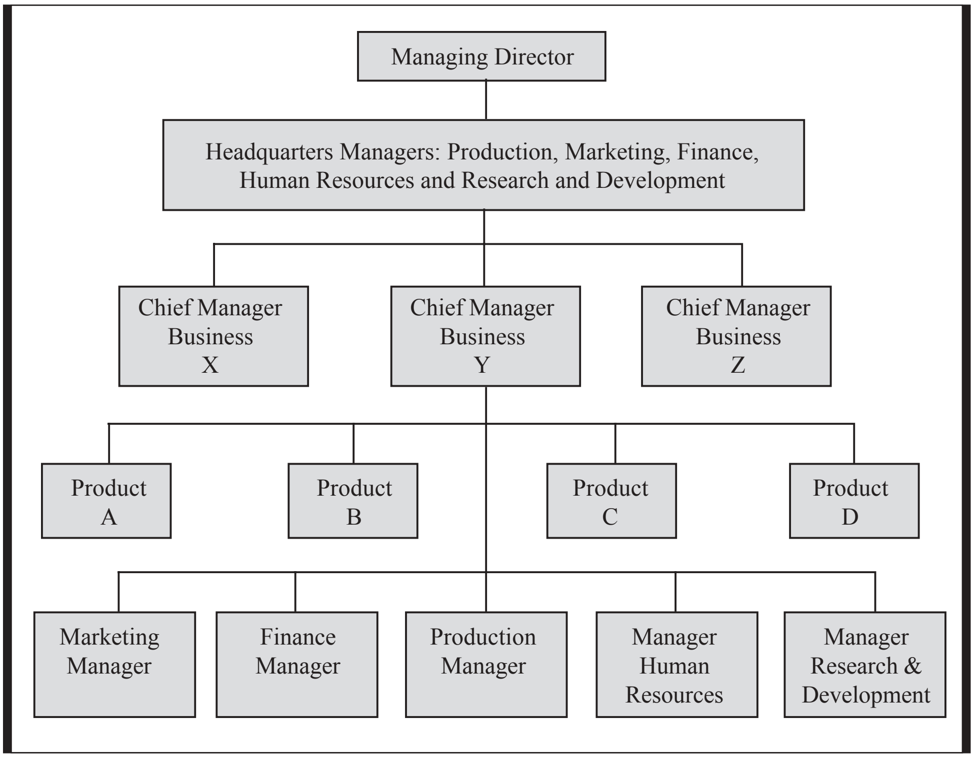


Fig. 3.3 : Decentralised life of Business Type of Organisation Structure

Source : Adapted from Thompson and Strickland, *op.cit.*, p. 226 and Joe G. Thomas, *op.cit.*, p. 267.

4. Strategic Business Unit Structure

A single chief executive cannot control a number of decentralised units of a broadly diversified company. The business can be effectively controlled, if the related businesses are grouped into strategic units and the efficient and senior executive is delegated with the authority and responsibility for its management. The senior executive will in turn report the matter to the chief executive. This arrangement will improve strategic planning and implementation, though it adds one layer in the organisational hierarchy. Top management co-ordinates the interests of the diversified business units.

A strategic business unit is a grouping of business subsidiaries based on some important strategic elements common to each. The common or related elements could be an overlapping set of competitors, a closely related strategic mission, a common need to compete globally, an ability to accomplish integrated strategic planning, common key success factors and technologically related growth opportunities. *Figure 3.4* presents SBU type of organisation structure.

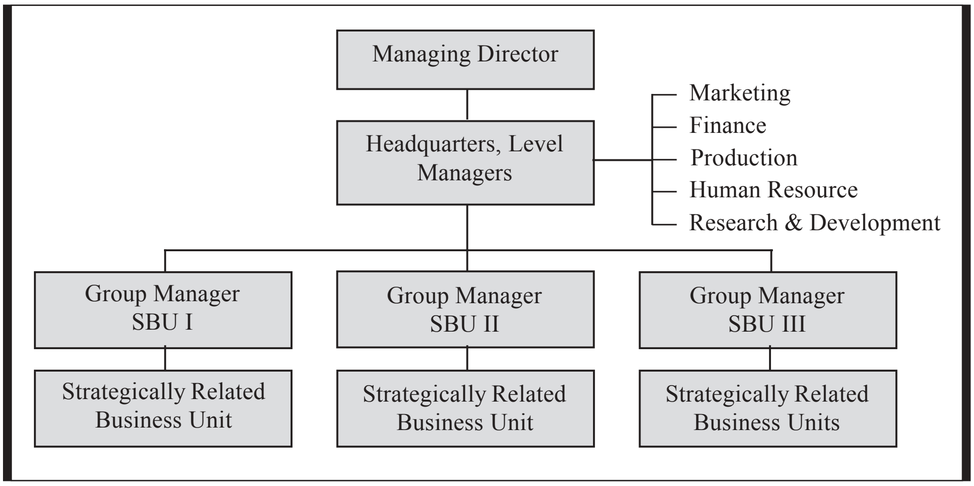


Fig. 3.4 : Strategic Business Unit Type of Organisation Structure

Advantages: The advantages and disadvantages of the strategic business unit structure are presented in *Exhibit 3.4*.

EXHIBIT 3.4 ADVANTAGES AND DISADVANTAGES OF STRATEGIC BUSINESS UNIT (SBU) TYPE OF ORGANISATION STRUCTURE

Advantages	*Disadvantages*
• Provides a strategically relevant way to organise the business-unit portfolio of a broadly diversified company. • Facilitates the co-ordination of related within an SBU, thus helping to capture the benefits of strategic fit in the SBU. • Promotes more cohensiveness among the new initiatives of separate but related businesses. • Allows strategic planning to be done at the most relevant level within the total enterprise. • Makes the task of strategic review by top executives more objective and more effective. • Helps allocate corporate resources to areas with greatest growth opportunities. • Improves co-ordination among business facing similar strategic issues.	• It is easy for the definition and grouping of business into SBUs. SBU serves no other purpose than co-ordination of activities. • If the criteria for defining SBUs are rationalisation and have little to do with the nitty-gritty of strategy coordination, then the grouping loses real strategic significance. • The SBUs can still be myopic in charting their future direction. • Adds another layer to top management. • The roles and authority of the managing director, general manager, SBU level managers have to be carefully worked out. • Unless the SBU head is strong willed, very little strategy co-ordination is likely to occur across business units in the SBU. • Performance recognition gets blurred; credit for successful business units tends to go to business unit head, and last to group manager. • Increases layers of management. • May result in SBU goals that differ from corporate goals.

The advantages of this structure include: *(i)* Reduction of the corporate headquarters' span of control. The chief executive at the corporate headquarters has to control the general managers of the strategic business units. *(ii)* This structure permits better coordination between divisions with similar missions, products, markets and technologies. *(iii)* It allows strategic management to be done at the most relevant level within the total enterprise. *(iv)* It helps to allocate corporate resources to areas with greatest growth opportunities. *(v)* Business units are organised based on the strategically relevant method.

Disadvantages: The strategic business unit structure also has certain disadvantages. *(i)* The first disadvantage is that corporate headquarters becomes more distant from the division. *(ii)* Conflicts between/among the strategic business unit managers for greater share of corporate resources can become dysfunctional. *(iii)* Corporate portfolio analysis becomes a complicated one in this structure.

5. Matrix Organisation Structure

Organisational structures discussed earlier have possessed a single chain of command. In other words, employees in those structures report, to only one manager. But, the organisation structure possesses a dual chain of command. Both functional and project managers exercise authority over organisational activities, in matrix structure. Thus personnel in this structure have two superiors, *viz.*, a project manager and the manager of the functional department at the headquarters level. *Figure 3.5* presents the matrix organisational structure.

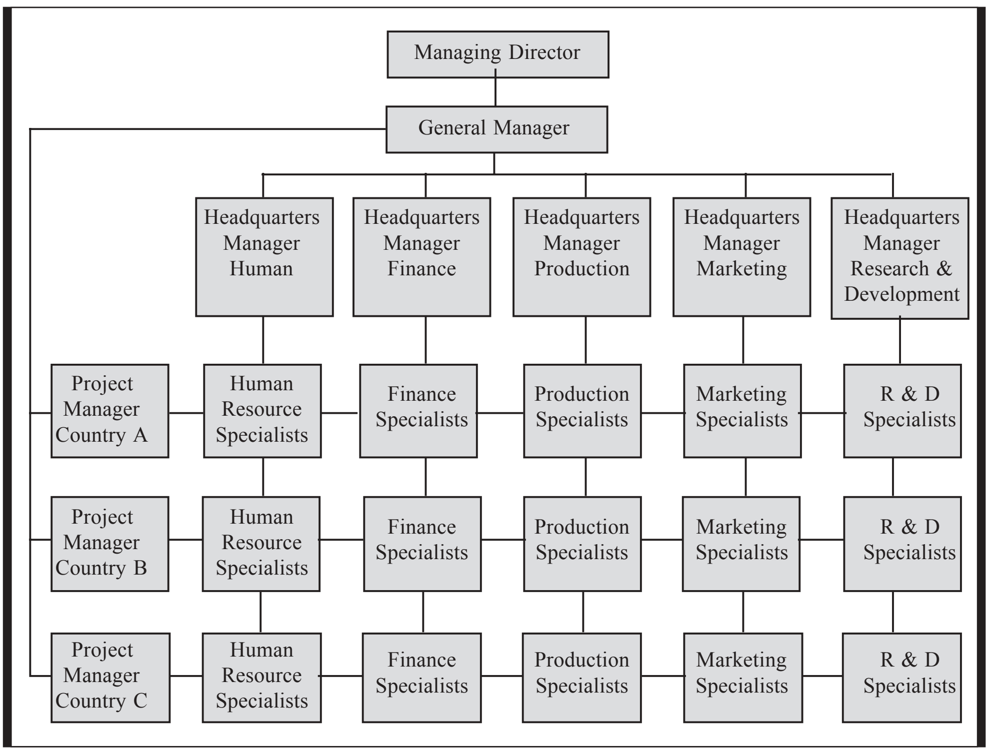


Fig. 3.5 : Matrix Organisation Structure

A matrix organisational structure is appropriate when:

(i) Management attention must be focused on two or more key issues (technical issues, consumer needs, functional efficiency).

(ii) Large amounts of diverse information need to be processed.

(iii) Problem solving is complex (environmental uncertainty, interdependence among organisational units, complex products or technology).

(iv) Economies of scale require the sharing of human resource expertise to achieve high performance.

Advantages: The matrix structure is commonly used in the firms whose technological change is rapid. The advantages of matrix structure include: *(i)* the company can have the advantages of both project type of organisational structure and functional organisation structure. *(ii)* Functional personnel are paid for their services whenever, they are used by project managers. This practice enables the management to reduce the cost. *(iii)* This structure has considerable flexibility. The personnel can be transferred from one project to the other depending upon the need of the project. *(iv)* The lower level functional employees are highly motivated and satisfied with their job as they are involved in decision making. *(v)* Each project manager is in charge of a unit. Therefore, he can be developed as a general manager through performing general management functions. *Exhibit 3.5* presents the strategic advantages and strategic disadvantages of matrix organisational structure.

EXHIBIT 3.5 ADVANTAGES AND DISADVANTAGES OF MATRIX ORGANISATION STRUCTURE

Advantages	*Disadvantages*
• Give formal attention to each dimension of strategic priority. • Creates checks and balances among competing viewpoints. • Facilitates capture of functionally based strategic fits in diversified companies. • Promotes making trade-off decisions on the basis of, "what is best for the organisation as a whole". • Encourages co-operation, consensus-building, conflict resoultion and co-ordination of related activities. • Permits focus of attention on more variables and encourages generation of new ideas. • Makes efficient use of functional expertise. • Facilitates operation in complex and dynamic environment. • Encourages optimisation of organisational goals. • Managers are aware of strategic issues.	• Very complex to manage. • Hard to maintain balance between the two lines of authority. • So much shared authority can result in a transactions long jam and disproportionate amounts of time being spent on communications. • It is hard to move quickly and decisively without getting clearance from many other people. • Promotes an organisational bureaucracy and hamstrings creative entrepreneurship. • Violates unity of command. • Managers should have interpersonal skills. • Requires too much time for meetings and collaboration. • Requires decision making input from many sources. • May result in conflict between functional and project managers.

Disadvantages: The significant disadvantages of matrix organisational structure include: *(i)* Greater administrative costs associated with its operation. Personnel spend much of their time in meetings and exchanging of information to co-ordinate functional areas with projects. *(ii)* In view of the two forms associated in this structure, they are characterised by conflicts. The most critical conflict is between functional managers and project managers. *(iii)* Functional employees experience stress by working in matrix structure. Reporting to two bosses, creates role ambiguity and role conflict. Some companies reverted their organisational structures back to traditional structures from matrix structures due to these problems.

6. Team Organisation Structure

Strategies of business are not always static. They go on changing depending upon internal and external environmental factors. Hence, a single type of organizational structure is not suitable for all times and all situations. Blending the basic forms of organization to match the structure to strategy in the units concerned is essential. Another option is to supplement special situation devices to the basic organisational structure. This option is Team structure.

Team structure takes three (3) forms *viz., (i)* Project Team, *(ii)* Task Force Team, and *(iii)* Venture Team.

(i) **Project Team:** Projects teams are created to handle special kinds of situations with a finite life expectancy. Project teams are self-sufficient work groups. These are created to supervise the completion of a special activity. The special activities include: setting up new technological process, starting up a new venture, producing a new product, initiating and completion of a joint venture an the like.

(ii) **The Task Force Team:** Interdisciplinary assignments necessitate the formation of task force team. A task force team consist of top-level executives and specialists in different areas from the organization. The advantages of special task force team include: increased opportunity for creativity, open communication, cross-functional authority, effective integration of talents, quick conflict resolution, collaborative approach for problem solving.

(iii) **The Venture Team:** Venture team is a group of individuals. The purpose of forming this group is to bring a specific product or a new business into being. The problems of venture teams are: *(i)* Difficulty of deciding the manager to whom the report should be made, *(ii)* Source of funding to venture i.e. is the source from department or business corporation, *(iii)* Methods of keeping the venture clear of bureaucratic and vested interests, and *(iv)* Problem of coordinating large number of different ventures.

7. Virtual Organisational Structure

Cobblers in Kanpur, Kharagpur and in many cities of India manufacture shoes for Bata as per the specifications prescribed by the latter. Transport Corporation of India transports the shoes from manufacturing to all retail outlets appointed by Bata. CommAds advertises for Bata. Thus different organizations perform different tasks for Bata. Bata enjoys either the profits or bears the loses driven out of the total business operations. Thus, Bata does business without performing all or other majority of the business operations. This type of arrangement through outsourcing is called virtual organisational structure.

Virtual Organisational Structure does not physically exist, but its effect is felt. Globalisation and information technology have enabled large-scale outsourcing and as such the virtual organisational structure has become popular.

Advantages: *(i)* These structures enable for doing business with less capital, less human resources and less inputs, *(ii)* These structure provide for flexibility of operations, *(iii)* These structures react to environmental demands most effectively, *(iv)* These structures develop the ancillary industries.

Disadvantages: *(i)* Companies do not have strong foundations or strengths in their operations, *(ii)* Organizations have to depend heavily on outsourcing, *(iii)* Failure in the network results in the failure of the entire organization.

(G) RELATIONSHIP BETWEEN HEADQUARTERS AND SUBSIDIARIES

The MNC can directly manage, if the number of subsidiaries are few. If the number of subsidiaries are more in number, it has to make a permanent structural relationship between itself and its subsidiaries. This is because, the MNC supplies various resources and inputs to its subsidiaries and also receives inputs from the subsidiaries. In addition, the activities between the MNC and subsidiaries need to be co-ordinated and controlled. In fact, the information technology provides on line facility to co-ordinate and control the activities.

The different aspects of relationships between the Headquarters and subsidiaries include:

- Information sharing
- Resource sharing
- Decision flows
- Co-ordination of activities
- Control of operations
- Strategy formulation.

Information Sharing: MNC headquarters share the information with subsidiaries. Information flows both directions. Headquarters receive the information from the subsidiaries regarding their markets, demand, customer problems, finances, product designs, country environment, daily sales, financial positions etc. *Similarly,* the subsidiaries get the information from the MNC headquarters regarding the approvals, employment of people etc.

Resource Sharing: MNC headquarters and subsidiaries share various type of resources among them like financial, human, material, and technology.

Decision Flows: Decisions made by the MNC headquarters flow to various subsidiaries for information and implementation. *Similarly,* subsidiaries inform the decisions made by them to the headquarters for approval and to other subsidiaries for information.

Co-ordination of Activities: MNC headquarters balance the production, demand for it, human resources, supply and demand for finances and any other inputs among the subsidiaries. *Similarly,* MNC coordinates the activities of subsidiaries and external stake holders like suppliers of inputs, bankers, market intermediaries, Governments of various foreign countries, customs officials etc.

Control of Operations: MNC headquarters control the operations of its subsidiaries based on the customer needs, competitor's positions, Government policies, rules and regulations of various countries, terms dictated by suppliers of materials and financial institutions.

Strategy Formulation: MNC headquarters help the subsidiaries to formulate the strategies for their countries. It further formulates global strategy. It directs and guides MNCs in implementing, evaluating and controlling strategies.

Strategic Management of MNCs

The basic steps in strategic management include :

- Formulation of mission, objectives and goals
- Analysis of external environment and internal environment in order to identify opportunities, threats, strengths and weaknesses
- Formulation of alternative strategies
- Evaluation of alternative strategies and selection of the right strategy
- Implementation of the strategy
- Evaluation and control of the strategy.

Most of the MNCs have broadened their missions and the reason for their existence. *For example,* Shell Oil and Amoco view their business as energy business rather than oil business, Coca-Cola and Pepsi view their business as food business rather than soft drink business. Some of the MNCs have reformulated the strategies in recent years in view of changing external environmental factors. *For example,* Unilever decided to revert to its core strategy. The company sold its other strategic business units like transport, oil milling, wallpaper, turkey breeding, etc., based on the SWOT analysis. It limited its business to its core activities like consumer goods and chemicals.

MNCs identify opportunities, threats, strengths and weaknesses based on environmental analysis. They formulate strategies based on SWOT analysis. *For example,* Deutsche Bank created a network of 250 branches, Alliance bought 50 per cent of shares in Staatliche Versicherung, a German Insurance Company, McDonalds opened its fast-food restaurants and the Big 'K' Mart of USA decided to close its business based on SWOT analysis.

MNCs formulate and reformulate strategies based on SWOT analysis and environmental changes. *For example,* the Taisei Corporation, a Japanese construction MNC started formulating systematic objectives and long-run plans from 1990. Statoil - a Norwegian oil and gas company, formulated research and development strategy and prevented a big trouble.

MNCs also evaluate and control the strategies. General Motors overtook Ford in Europe through a systematic strategic evaluation and control *i.e.,* by revamping its models and production line.

(H) MNCs IN INDIA

Most of the MNCs in India had originally entered the Indian market during the colonial era. They grew fast with state patronage. During the post independence era, the actual number of MNCs; who entered was small. The entry was generally made through collaboration with Indian big business. For instance, Bajaj Tempo and Telco joined hands with Daimler Benz of West Germany; Cynamid, Ciba and Ciba-Geigy jointly established new undertakings with Lalbhai House; Birlas became the spokesmen of Kaisers and Ford. Sarabhai, Murguppa Chettair, Naidu, Thapars, Kirloskars and other houses also joined to promote large private sector companies in collaboration with MNCs.

At the end of 1990, there were 469 foreign companies in India. In addition, there are many Indian companies with foreign equity participation. Several Indian outfits of MNC's like Pond's Johnson and Johnson, Lipton, Brooke-Bond, Colgate-Palmolive etc., are in low technology consumer goods sector. Hindustan Lever, while popular in low tech consumer sector, has diversified into a high technology and export oriented sectors. Ponds has diversified into thermometers and leather upper mushrooms entirely for exports (Ponds, Brooke Bond, Lipton and HLL come under the multinational umbrella of Unilever). ITC (Indian Tobacco Company formerly Imperial Tobacco Company) has diversified into areas like hotel, paper boards and edible oils.

There are several MNCs; in the pharmaceutical industry, like Glaxo, Bayer, Sandoz and Hoechist MNCs like Marubeni and Nissholwan confine to foreign trade.

Table 3.4 presents the number of top 500 MNCs operating in India and their country of origin.

Role of MNCs in India

There is no distinction between an MNC and a domestic company in India. The policy regarding MNC is the same as for foreign private capital in India. MNCs are specifically covered under Foreign Exchange Management Act (FEMA).Now, we study the operation of MNCs in India.

TABLE 3.4 COUNTRY OF ORIGIN OF TOP 500 MNCs OPERATING IN INDIA

Country		*No. of MNCs*	*Country*		*No. of MNCs*
USA	–	148	Netherlands	–	7
Japan	–	121	India	–	11
UK	–	43	Finland	–	6
Germany	–	33	Belgium	–	4
France	–	32	South Africa	–	6
Sweden	–	14	Spain	–	6
South Korea	–	13	Norway	–	3
Switzerland	–	10	Turkey	–	3
Australia	–	9	Mexico	–	2
Canada	–	9	Britain/Netherlands	–	2
Italy	–	7	Others		13
			Total		**500**

1. Profit Maximisation

Most of the private companies including MNCs have profit maximisation as the most important objective. However, MNCs are expected to operate fairly and behave like a Corporate Citizen. But the MRTP commission had shown that Philips has undervalued *(less than the cost of production)* its exports in order to reduce its tax liability to Indian Government.

2. International Network of Marketing

India expects the MNCs to increase their exports and earn foreign exchange for India. But most of the MNCs transfer the foreign exchange to their parent country, just in the name of imports from their home country.

3. Diversification Policy

India expects the MNCs to diversify their activities into the untapped areas and the priority areas like core industry and infrastructure industry. But majority of the MNCs diversify into the more profitable areas. *For example,* ITC ventured into hotel industry.

4. Concentration in Consumer Goods

Most of the MNCs entered Indian consumer market like HLL due to the high profitability rather than capital goods market which is less profitable.

5. Location of Central Control Offices

MNCs diversify their activities to various countries having their central control offices which provide them maximum global advantage. Unilever, though a company born in Holland, took up British for operations in erstwhile British Colonies.

For example, the erstwhile USSR never favoured import of consumer goods from the underdeveloped countries. But, India had been provided with a special status. Indian exports received a preferential treatment from USSR. Most share of this preferential treatment was snatched away by Bata, HLL, Nestles (even when it is canalised through the India Coffee Brand). Thus, MNCs have been using India as a good platform for extending their operations in the third world.

6. Techniques to Achieve Public Acceptability

MNCs adopt a number of techniques to get the acceptability of the people of the country wherever they operate. *For example,* companies like Mulchandani Electronics and ITC Ltd., are more acceptable to Indians.

Products of Lipton Unilever Company are more acceptable to most of the Indians. HLL and Colgate-Palmolive use Hindu sentiments in their advertisements. *For example*, Colgate-Palmolive used Cow and Calf in their toothpaste advertisement. Thus, most of the MNCs try to project themselves as if they were completely identified with the Indian culture and Indian economic policies. They also claim that they have acquired Indian nationality. It is criticised that MNCs in India use also these techniques to improve their business.

7. Existence of Modern and Sophisticated Technology

As stated earlier, maximisation of global profits is one of the major objectives of MNCs. MNCs develop modern and sophisticated technology in order to produce the products of high quality and lowest cost of production. They bring the technology to the developing world, but they do not provide the latest technology to the domestic companies of the third world.

The Indian Government requested MNCs to provide their technology to Indian companies even before the economic liberalisation in 1991 through joint ventures. But MNCs in India normally carry-out their business on their own rather than collaborating with the Indian business houses. Thus MNCs forced India to depend on them for latest technology. In view of this experience, MNCs should be allowed to invest in India through joint ventures or technical collaboration with the Indian companies.

8. Business, But Not Social Justice

MNCs are in business but not in social service. They believe in the superiority of free market economies. MNCs allocate their investments according to market demand in order to maximise their profits.

Wide gap between the rich and poor has been one of the characteristics of India since long back. Therefore, a section of the Indian economy enjoys higher standard of living. MNCs in India have been concentrating only on this section in designing the product, pricing and services. MNCs normally do not produce the products to cater to the needs of poor section. They leave the poor section to the local business. Thus, the more profitable business is grabbed by MNCs and the left the less profitable business to the local markets.

9. Unconcern Towards Social Responsibilities and Business Ethics

It is also criticised that MNCs try to maximise their profits and do not think of discharging their responsibilities towards Indian society. Further, it is criticised that MNCs exploit the Indian natural resources indiscriminately, export the products from India to other countries and transfer the proceeds of sales to their home countries.

In addition, it is criticised that MNCs price the products exclusively based on business principles like supply of and demand for products rather than the social considerations. It is also criticised that MNCs resort to unethical means in the process of profit maximisation by exploiting natural resources and water resources meant for people at large. (*See Box 3.2*)

BOX 3.2 COCA COLA WAS URGED TO CLOSE ONE OF ITS INDIAN PLANT

Coca- Cola was urged to consider shutting down a bottling plant in the drought-stricken state of Rajasthan, saying that the plant is depleting scarce water supplies. The report on pesticides and allied issues expressed concern about the company's use of scarce water supplies — an issue that has been raised repeatedly by villagers who live near several of the company's bottling sites. The assessment looked at 6 of the company's 49 bottling plants in India, but highlighted conditions at the Kaladera plant in Rajasthan. The plant's presence in this area would "continue to be one of the contributors to a worsening water situation and a source of stress to the communities around," it said. The company should find alternative water supplies, relocate or shut down the plant, the report concluded.

Source: Adapted from The New York Times January 16, 2008

10. MNCs and Process of Planned Economic Development in India

There was a confusion with regard to the role of MNCs in Indian planned development. Most of the MNCs operating in India during that period had different plans which were incompatible with the Indian five year plans.

11. Cultural Erosion

Indian culture with regard to dressing patterns, eating habits, building and maintaining the relations etc., are quite distinct from the rest of the world. But, it is widely criticised that the MNCs activities with regard to type of the products *(mainly cigarettes, liquor, beverages like coke etc.)*, advertisements and the like, erode the Indian culture.

12. Unconcern for Environmental Pollution and Ecological Balance

It is widely criticised that MNCs in India did not invest in environmental polluting controlling equipment as they normally do in their home country. This in turn resulted in environmental pollution in a number of instances in the country. *For example,* Bhopal gas tragedy and also failure of Union Carbide in paying due compensation to the victims is an example.

Further, it is criticised that the MNCs in India are also unconcerned in maintaining ecological balance in the country.

However, MNCs contribute to some extent for the growth of Indian economy, industry and business. These criticisms forced MNCs to Indianise their operations.

(I) THE INDIANISATION OF TRANSNATIONALS

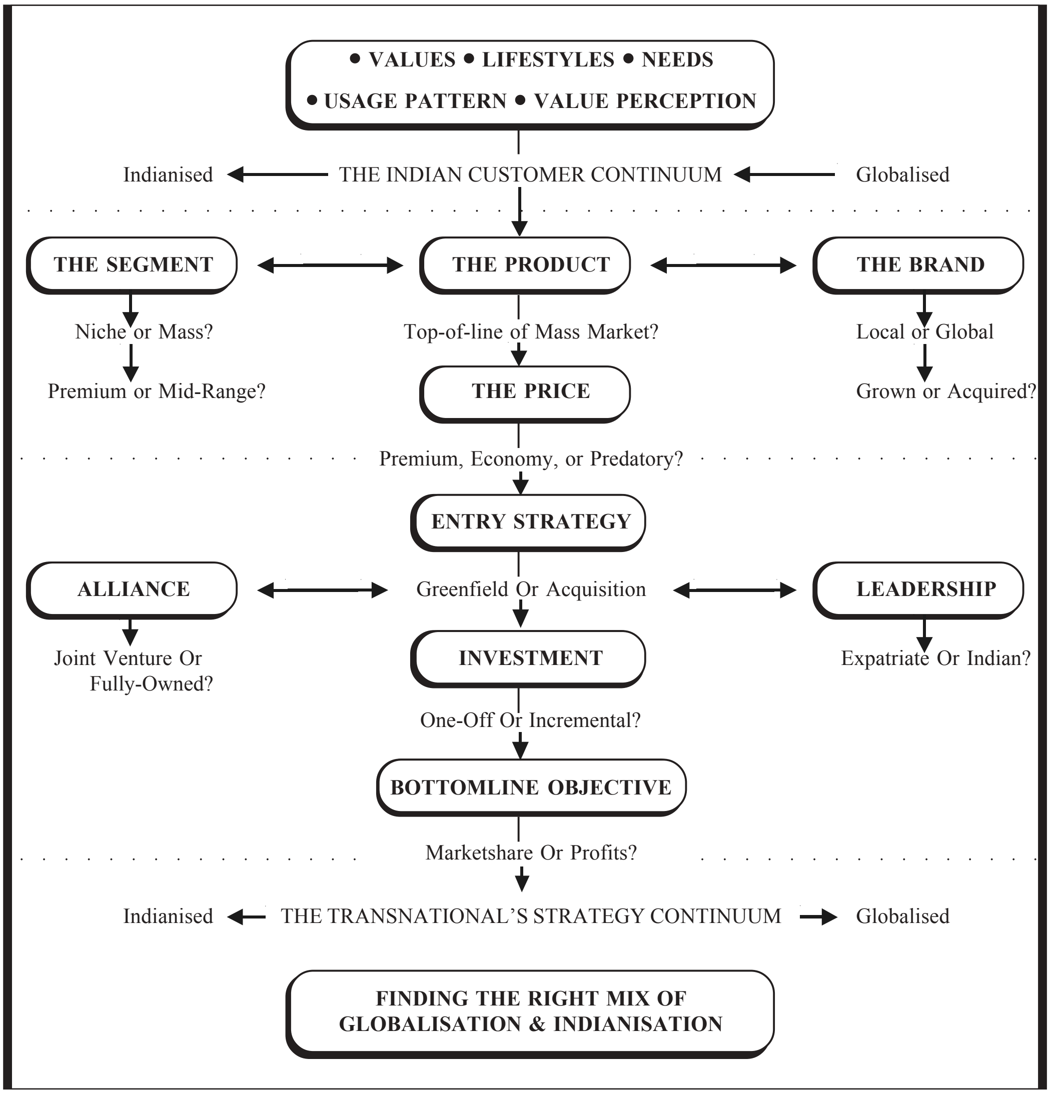
Transnational corporations operating in India have been trying to win over the country's one billion customers. It is now clear that the long-accepted law of globalisation, *viz., 'One World, one Strategy'* does not hold good. Squeezing profits out of new markets like India with old products, sunset technologies, global corporate centre will not work.

MNCs in India

As C.K. Prahlad and Ken Lieberthal put it, "the needs of global competitiveness have ensured that the old ways of doing business will not suffice." Hence, the Indianisation of the transnational is becoming evident. Global Corporations are deviating from their international methodologies and are developing their strategies for local markets. The Ford Motor Company announced that its next car, the Ikon, has been designed exclusively for India. LG Electronics is using purely Indian brand name like Sampoorna, for its TV Sets. Coca-Cola has redesigned its distribution-crates and trucks for safe delivery through India's rough roads. Electrolux is working on a made-for-India refrigerator designed to serve just three basic purposes *viz.*, chill drinking water, keep cooked food afresh and withstand long power cuts.

IndMianise a Global Company

Some of the Transnationals are as flexible as Indian companies. According to Arun Maira, the flexibility depends on how much diversity a transnational can accommodate and how many of its global standards it needs to maintain. Two major strategies are available to a global company *viz.*, *(i)* Following a rigid globally-erect template and *(ii)* Clean-slate localisation. Some transnationals Indianise in some areas and pick-up global practices in other areas. The global companies to be successful should follow this strategy. Benckiser failed to impress Indian customers with its Jovan and Coty Healthcare cosmetics. Coca-Cola failed in impressing the Indian customers through its global advertising campaigns. *Figure 3.6* presents how to Indianise a global company.



However, some companies are successful in Indianising themselves by bringing deviations. *Exhibit 3.6* presents how transnationals Indianised for success.

POINTS TO BE REMEMBERED

- TNC produces, markets, invests and operates across the world.
- MNC responds to the specific needs of the different country markets regarding product, price and production. Thus, MNC operates — in more than one country, but operates like a domestic company of the country concerned.
- Developing countries allow the MNCs to enter their countries due to the technological, financial and managerial superiority.

- However, some countries control the operations of MNCs in their country due to negative impact of MNCs.
- The organisational structure of MNCs include: product organisation structure, geographical organisation structure, decentralised business divisions, strategic business units and matrix organisation structure.
- MNC headquarters and subsidiaries maintain close relations with each other regarding all types of business operations.
- MNCs have been increasing their operations in India.
- MNCs operating in India have been Indianising their operations.

KEY WORDS

- International Corporation
- Global Corporation
- Market Territory
- Political Interference
- Headquarters - Subsidiary Relationship
- Multinational Corporation
- Transnational Corporation
- Product Innovation
- Organisation Design
- Indianisation of Transnationals

QUESTIONS FOR DISCUSSION

1. What is a Multinational Corporation? How is it different from a global company, international company and transnational company?
2. Why do developing countries allow MNCs to operate in their countries?
3. Why do some countries impose controls over MNCs?
4. Explain the organisational structure of MNCs.
5. Discuss the headquarters subsidiary relationship.
6. Explain the role of MNCs in Indian economy. Why would TNCs like to Indianise their operations?

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Unit Four

INTERNATIONAL FINANCE AND FOREIGN EXCHANGE

CHAPTER OUTLINE

(A) INTERNATIONAL FINANCE

Most of us know that domestic business agreements are concerned with the basic issues like price, quantity and delivery date. But, international business agreements are concerned with other issues, in addition to the issues involved in domestic trade. These issues include:

- Currency to be used in the international business transactions.
- Creditworthiness of the importer.
- Acceptable methods of payment.
- Arranging finance.

Currency to be used

Selecting currency to be used for settling the international business transactions is an important issue in international finance. The exporter prefers to have his home currency or hard currency while the importer prefers to pay in his home currency. If the currency of the importing country is weak, the exporter prefers the payment in hard currencies like US dollars, UK pound, Japanese Yen and French Francs. The exports of most of the developing countries are invoiced in US dollar. Some companies prefer to settle their transactions in US dollar or other hard currencies.

As such the hard currencies are the choice of the exporter for settling the transactions in international business. Hence, the importers and countries struggle to earn hard currencies in order to meet their import bills. Next, the exporter is interested to know the importer's creditworthiness.

Creditworthiness of the Importer

The exporter normally first arranges for the shipment of the goods and receives the money at a later stage. There would be an amount of risk involved in the payment of money by the importer. Hence, the exporter either should have a satisfactory business relations with the importer or the exporter may ask the importer to send his credit rating done by an internationally reputed firm.

Export-Import Bank of the USA, Export-Import Bank of India and such other organisations provide credit rating information to the exporters by collecting a fee. The exporting firms which do not demand for credit rating face serious problems. *For example,* one small US manufacturer exported fan blades worth of US $ 127,000 to a new customer in Africa and failed to get the payment even by handing over the account to a collection agency.

After evaluating the creditworthiness of the importer, the exporter and importer should come to an understanding regarding the method of payment.

Methods of Payment

Both the exporter and importer should agree on a particular type of payment, after assessing the importer's creditworthiness. The methods of payment include:

- Payment in advance
- Open account
- Documentary collection
- Letters of credit
- Credit cards
- Counter-trade.

- **Payment in Advance:** Most of the exporters prefer the advance payment prior to shipment as it involves no risk. This method is most undesirable from the point of view of the importer due to the involvement of heavy risk in getting the delivery of the goods as per the order.
- **Open Account:** Under open account the importer first receives the goods and then arranges for the payment. Hence, it is the safest form of payment from the point of view of the importer. This form is undesirable and risky from the viewpoint of the exporter. This method is more suitable when the importer's creditworthiness is certified by an authorised agency or when the exporter has well-established long-term relation with the importer.
- **Documentary Collection:** International financial institutions and banks have developed a number of financial instruments due to the risks and problems involved in advance payment and open account. One of the important financial instruments is documentary collection.

Under this method the commercial banks facilitate the payment process. The exporter draws up a document called a bill of exchange, in which payment is demanded from the importer at a specified future date. There are two types of bills of exchange, *viz.,*

(a) Sight Bill of Exchange

(b) Time Bill of Exchange

(a) Sight Bill of Exchange requires payment immediately after the transfer of title of the goods to the importer by the exporter. The importer's bank after receiving the bill of lading and sight bill of exchange from the exporter's bank, asks the importer to arrange for the payment. The bank gives the bill of lading to the importer after the payment is made by the importer. *Figure 4.1 presents the transactions using a Sight Bill of Exchange.*

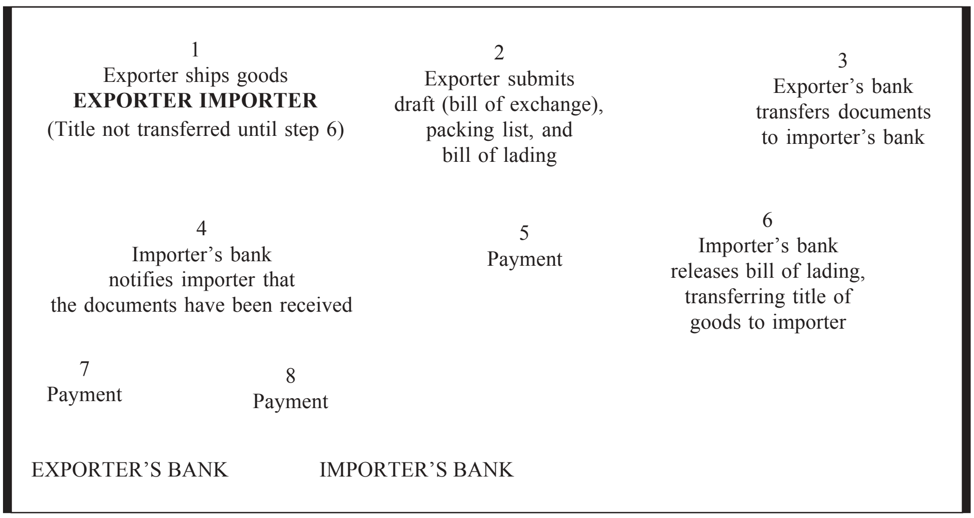

Fig. 4.1 : Transactions using a Sight Bill of Exchange

Source : Ricky W. Griffin and Michael W. Pustay, *op.cit.,* p.658.

(b) Time Bill of Exchange requires the importer to arrange for the payment after some time (60 days or 90 days) receiving the possession of goods. The importer writes, "Accepted" on the bill of exchange offer after obtaining the bill of lading (*i.e.*, after obtaining the title of goods). This document is called 'Trade Acceptance.' Trade acceptance is legally enforceable by the law of the most of the countries. This is a negotiable debt instrument.

The importer may not keep up his promise and fail to pay to the exporter, under the documentary collection. Thus there is the involvement of risk in this method of payment also. As such the banks developed another method of payment, *i.e.*, Letters of Credit.

- **Letters of Credit:** This instrument is carried out to avoid the risk involved in other methods of payment.

  A letter of credit is an instrument issued by a bank wherein the bank promises the exporter to pay upon receiving the proof that the exporter completed all the necessary formalities specified in the document. This guarantees the exporter regarding payment and hence, the payment is free from risk. The importer bank does this work by collecting a fee from the importer and also after obtaining a security to this effect. *Figure 4.2 presents the transactions using a letter of credit.*

1 Sales contract specifies payment using letter of credit	2 Importer applies to a local bank for letter of credit	3 Importer's bank informs exporter's bank when letter of credit has been issued.
4 Exporter's bank advises or confirms letter of credit	5 Exporter ships goods	6 Exporter sends documents to his bank
7 Documents sent for review	8 Bank sends documents to importer	9 Amount due is paid for (bank may extend credit)
10 Importer's bank transmits funds due to exporter	11 Exporter receives payment	
EXPORTER EXPORTER'S BANK	IMPORTER IMPORTER'S BANK	

Fig. 4.2 : Transactions Using Letter of Credit

  However, this instrument is costly for the importer. Hence, another instrument, *i.e.*, credit card is developed.

- **Credit Cards:** Credit cards are used for small international business transactions by the market intermediaries like retailers and also by the customers. Various credit cards include: American Express, Visa and Master Card.

  The next method of payment is counter-trade.

- **Countertrade:** As discussed in *Chapter 18* (International Marketing), counter-trade is an arrangement to pay for import of goods and services with something other than cash. Thus, counter-trade is goods-for-goods deal.

Types of Countertrade: Types of counter-trade include: barter, counter purchase, compensation trade, switch trading, offsets and clearing agreements.

Exhibit 4.1 presents particulars of Different Methods of Payment for international business.

EXHIBIT 4.1 PAYMENT METHODS FOR INTERNATIONAL TRADE

Method	*Timing of Payment*	*Timing of Delivery of Goods*	*Risk(s) for Exporter*	*Risk(s) for Importer*	*Availability of Financing for Exporter*	*Condition(s) Favouring Use*
Payment in advance	Prior to delivery of goods	After payment, when goods arrive in importer's country	None	Exporter may fail to deliver goods	N/A	Exporter has strong bargaining power; importer unknown to exporter
Open account	According to credit terms offered by exporter	When goods arrive in importer's country	Importer may fail to pay	None	Yes, by factoring of exporter accounts and account receivable	Exporter has complete trust in importer; importer is part of the same corporate family
Documentary collection	At delivery if sight draft is used; at specified later time if time draft is used	Upon payment if sight draft is used; upon acceptance if time draft is used	Importer may default or fail to accept draft	None	Yes, by discounting draft from its face value	Exporter trusts importer to pay as specified; when risk of default is low
Letter of credit	After terms of letter of credit are fulfilled	According to terms of sales contract and letter of credit	Issuing bank may default; documents may not be prepared correctly	Exporter may honour terms of letter of credit but not terms of sales contract	Yes, by discounting letter from its face value	Exporter lacks knowledge of importer; has good credit with local bank
Credit card	According to normal credit card company procedures	When goods arrive in importer's country	None	Exporter fails to deliver goods	N/A	Transaction size is small
Counter trade	When exporter sells countertraded goods	When goods arrive in importer's country	Exporter may not be able to sell counter traded goods	None	No	Importer lacks convertible currency; importer or exporter wants access to foreign distribution network

(B) INTERNATIONAL FINANCIAL ENVIRONMENT

International financial environment influences the size, pattern and direction of international business. Initially, the exchange rates were determined on the basis of the value of metal contained in the coins of the two countries. This system was referred to as the commodity specie standard. This system was followed by gold standard.

Gold Standard: Gold standard experienced a key day between 1870s and 1914, which was suspended during the Great War. However, it was readopted, but was finally abandoned by 1930s. Gold standard was initially adopted by Britain. Later, Germany, Japan, the USA and other countries also adopted gold standard. The US Gold Standard Act of 1900 institutionalised the dollar-gold link.

Central Bank was maintaining official parity between its currency and gold and as such needed an adequate stock of gold reserves. Policy makers viewed external balance not in terms of a current account target but as a situation in which central bank was neither gaining gold from abroad nor losing gold to foreigners at too rapid a rate. Bank notes were exchanged for gold on demand. The price of gold was officially set at which it was bought and sold. The gold exchange standard was liberal as the currency was convertible into gold only through a currency being on gold specie standard. Rouble of Russia was convertible into British Pound and British Pound was convertible into gold. Gold standard allowed free flow of gold among countries and for automatic adjustment in exchange rates and in balance of payments. Deficit in the balance of trade led to the outflow of gold. The fixed supply of gold led to the demise of gold standard.

The Bretton Woods Systems of Exchange Rates

The collapse of gold standard led to the conduct of the Bretton Woods Conference in July 1944 and the establishment of International Monetary Fund in 1945 and evolution of a new system of exchange rates, which is known as the Bretton Woods System of Exchange Rates. Bretton Woods System of exchange ratio represented a fixed parity system with adjustable pegs. Under this system, each country was to fix the par value of its currency in terms of gold or US dollar. Monetary authorities were allowed to make adjustments to the extent of ±1.0 of the fixed par value. Though this system could bring about stability in the exchange rate, it could not sustain for a long time.

Exchange Rate Regime since 1973

The committee appointed by the IMF suggested four options, in the wake of collapse of the Bretton Woods System of Exchange Rates. These suggestions were accepted by the IMF and incorporated into the text of the Second Amendment to the Articles of Agreement. These suggestions include : *(i)* Floating-Rate System, *(ii)* Pegging of Currency, *(iii)* Crawling Peg, *(vi)* Target-zone Arrangement.

- **Floating Rate System:** Marketing forces determine the exchange rate of currencies under floating rate system.
- **Pegging of Currency:** Under this system a developing country pegs its currency either to a strong currency or to a currency of a country with which it has a large share of trade. Pegging system provides for fixed exchange rate between the two currencies. However, the exchange rates float with respect to the other currencies.
- **Crawling Peg:** Crawling peg is a hybrid of fixed rate and floating rate. The exchange rate of a currency with which it is pegged is stable in the short run, but it changes gradually over a period of time in order to reflect the changes in the market. This system has the advantages of stability and flexibility.
- **Target-Zone Arrangement:** Under this system the exchange rates are fixed with respect to the currencies of the countries of a particular zone and the exchange rates float with respect to the countries outside the zone. *For example,* Eastern Caribbean Currency Union, Central African Economic and Monetary Community and Western African Economic and Monetary Union.

Now, we shall study the theories of exchange rate behaviour.

Theories of Exchange Rate Behaviour: The theories of exchange rate behaviour are classified as follows :

- Balance of Payments Approach
- Monetary Approach
  - Monetary Approach of Flexible-Price Version
  - Monetary Approach of Sticky-Price Version
- Portfolio Balance Approach

Balance of Payments Approach: This theory is proposed by Allen and Kennen. According to this theory, in-flow of foreign exchange takes place under the following two situations :

(i) through export of goods and services when the price level in the domestic country is lower compared to that in foreign countries.

(ii) through foreign investment when the interest rates in the domestic country are higher than that in foreign countries.

The increase in in-flow of foreign exchange and foreign capital enhances the value of domestic currency against the foreign currencies.

The opposite situations reduce the value of domestic currency against foreign currencies.

According to this theory, the value of domestic currency against foreign currencies increases consequent upon increase in exports and in-flow of foreign capital and *vice-versa.*

Monetary Approach of Flexible – Price Version : Frenkel proposed this theory. According to this approach, the exchange rate between two currencies is fixed on the basis of demand and supply of money in the two countries. Thus, the demand for and supply of money in two countries determines the exchange rate of the currencies of these two countries. Demand for money is positively related to prices and output and is negatively related to interest rate. Increase in supply of money results in raising of domestic prices which in turn reduce the value of domestic currency. Higher growth rate of money supply than that of real output results in decline in domestic prices and increase in the value of domestic currency and *vice-versa.*

Monetary Approach of Sticky-Price Version : This theory proposed that increase in money supply results in decline in value of domestic currency. However, increase in the real output contributes for the increase in the value of domestic currency. This theory is based on the following assumptions :

- Money supply in a country is positively related to market interest rate.
- Purchasing power parity theory applies in the long run. As such, the expected inflation differential changes influence the exchange rates.

Portfolio Balance Approach : This theory emphasises that the exchange rate is determined based on not only inflow and outflow of foreign exchange, but also the holding of financial assets like domestic and foreign bonds.

According this approach, the exchange rate is determined on the basis of the interaction of real income, interest rates, risk, price level and wealth. The investor modifies the portfolio based on the change in any of these rates or variables. This rebuilding of portfolio influences the demand for foreign assets and thereby the exchange rate. Demand for foreign currency reduces the value of domestic currency and *vice-versa.* Further, the change in the exchange rate brings corresponding change in the portfolio. Thus, the changes portfolio structure influence the exchange rate and the changes exchange rate influence the portfolio. The natural influences continue until an equilibrium is reached between these factors.

(C) GLOBAL CAPITAL STRUCTURE

Capital is the basic resource for any kind of business either domestic or international. Capital is of two kinds *viz.,* equity and debt. Capital provided by the owners is called equity capital. Capital secured in the form of loans from banks and other institutions is called debt capital. Debt capital must be repaid with certain agreed rate of interest over certain agreed period. The company has no obligation to repay the equity capital or any return. However, the companies pay dividend to the equity shareholders, whenever, they have surplus or distributable profits. However, equity shareholders enjoy higher returns, whenever the companies enjoy higher rate of profitability. Therefore, the companies prefer high proportion of equity capital and low proportion of debt capital during the early days of inception as well as during the periods of low profitability as they have less commitment of interest payment on debt capital. In contrast, the companies prefer high proportion of debt capital and low proportion of equity capital in order to increase the profit share to the equity shareholders and maximise the equity shareholders' worth.

Trade-offs between equity and debt plays a vital role in maximising the equity shareholder's worth and also reducing the company's commitments of interest payment. The size of the firm, spread of its operations, stage in firm's life cycle and the strategies it employs determine the proportion of equity capital and debt capital in the total capital.

The companies should carefully determine the level of equity capital and debt capital as and when they expand, diversify and integrate the operations and activities. They can also make use of accumulated profits and generated reserves based on earlier period profits to meet the increased demand for capital. International business firms determine the proportion between equity capital and debt capital based on debt-equity structure of partner companies or debt-equity structure of the competitive firms in the host country. The foreign subsidiaries normally prefer higher proportion of debt capital as parent companies view equity capital in a foreign country would be at risk. However, financing the foreign subsidiary through debt capital would be at risk as it involves debt servicing that results in cash outflow in fixed schedules to the lenders. The parent company would face a problem of strict controls of repatriation in some countries, if it finances the subsidiaries by means of high proportion of equity capital during the periods of heavy profits.

The option of high proportion of debt capital has certain limitations. Normally, the debt market is less developed in most of the developing countries. The debt market in most of the small countries cannot afford to meet the debt capital requirements of the subsidiaries of MNCs in their countries. The third country debt market may not be interested in providing the debt capital in view of the risks involved in it. Therefore, the parent company is forced to provide debt capital also either from its own sources or from its guaranteed sources.

The larger MNCs, have their financial subsidiaries to meet their and their subsidiarie's capital needs of both equity capital and debt capital. However, the development of money market and capital markets in most of the countries reduces the hindrances for acquiring debt capital in host countries themselves.

Global Cash Flow Management

Working capital management deals with short-term financing. Cash flows in multiple directions in case of a multinational company. MNCs have to plan, organise and monitor the cash inflow and cash outflow in order to maintain proper liquidity.

Operating cash flows include direct and indirect cash flows. Direct cash flows include inflows and outflows.

Operating cash flows are necessary for day-to-day business activities in order to pay for acquiring raw material and other kinds of inputs (accounts payable) including remuneration for employees. Operating cash inflows include the revenue received from sales (accounts receivable). The indirect cash inflows include license fee and royalties received and outflows include license fee and royalties paid.

In addition to operating cash flows, there are financing cash inflows. Financing cash inflows are essential to service the existing funding sources, servicing debt, payment of dividends to the equity shareholders.

Operating cash flows of an MNC are multi-directional. *For example*, a Japanese MNC receives cash from its accounts receivables of the USA and pays cash to its accounts payable in South Korea and finances its Indian subsidiary. The Indian subsidiary in its turn pays cash to its accounts payable in the UK and receives cash from its accounts receivables in Malaysia.

MNCs sell either the finished product or semi-finished product to their subsidiaries. Similarly subsidiaries also sell either finished or semi-finished products to their parent companies. The price at which these goods/services are sold either to MNC or subsidiaries is called 'transfer price'. Normally the transfer price is equal to open market pricing. But, it would be difficult to compare the transfer price with open market price as open market price may not be available as MNCs and subsidiaries may transfer such products which are not traded in open market. The transfer price may favour either the parent company or subsidiary or both. But, such price affects the taxes in either of the countries or both the countries. Therefore, the governments may not agree with the transfer prices.

In addition, the MNCs and subsidiary need to pay license fee and royalties to either of them or to a third party. The license fee and royalties are calculated as a percentage of sales in the host country. Similarly, there are common overhead expenses and management expenses that are to be shared between the parent company and subsidiaries.

The parent companies provide equity capital as well as debt capital to the subsidiaries. Then subsidiaries have to pay interest to parent company regularly and dividend as and when they declare dividends. Parent companies provide additional equity capital and or debt capital to subsidiaries as and when the latter needs additional capital. Thus, there is a strong need for flow of cash from parent company to subsidiaries and *vice-versa.*

Cash Flow Management

Cash flows are managed either through a centralised treasury operations or through a decentralised system. The centralised system produces the advantages of economies of scale, services, expertise, etc. The centralised system provides the conveniences of flexibility and operational case. However, there are a number of systems to help MNCs, whether they follow the centralised system or decentralised system.

Netting: When the cash flows between parent company and its subsidiary, between subsidiary and subsidiary and among subsidiaries and parent company take place, the two-way cash flows are 'netted' against one another. Netting enables the companies to pay the net balances only.

Cash Pooling: MNCs and their units operating across the countries need to maintain larger sums of cash in order to have liquidity. But the larger amounts of cash increases the cost of working capital. Therefore, MNCs pool cash and capital of all its units in order to economise the cash and capital balances and flow.

(D) FOREIGN EXCHANGE

As discussed earlier, the importing country pays money to the exporting country in return of goods either in its domestic currency or in hard currency. This currency which facilitates the payment to complete the transaction is called foreign exchange. This foreign exchange is the money in one country for money or credit or goods or services in another country. Foreign exchange includes foreign currency, foreign cheques, and foreign drafts.

Foreign exchange is bought and sold in foreign exchange markets. The components of foreign exchange market include : the buyers, the sellers and the intermediaries. Foreign exchange market is not restricted to any place or country. In fact, foreign exchange in recent times is traded through on-line (Internet). Foreign exchange market is the market for currencies of various countries anywhere in the globe, as the financial centres of the world are united as a single market.

The market intermediaries of the foreign exchange market include:

- **Exchange Banks dealing in foreign exchange:** These banks discount and sell foreign bills of exchange, issue bank drafts, effect travellers' cheques and telegraphic transfers.
- **Bill brokers:** They help sellers and buyers to come together.
- **Acceptance houses:** They accept the bills of exchange on behalf of customers.
- **Central Bank of the country:** It also deals in foreign exchange

Exchange Rate Determination

The transactions in the foreign exchange market, *viz.*, buying and selling foreign currency take place at a rate, which is called 'exchange rate.' *Exchange rate is the price paid in the home currency for a unit of foreign currency.* The exchange rate can be quoted in two ways, *viz.*,

- One unit of foreign money to a number of units of domestic currency.
- A certain number of units of foreign currency to one unit of domestic currency.

For example, 1 US $ = Rs. 50 or Re. 1 = US $ 0.02

Exchange rate in a free market is determined by the demand for and the supply of exchange of a particular country. The equilibrium exchange rate is the rate at which demand for foreign exchange and the supply of foreign exchange are equal. Ragnar Nurske defined the equilibrium exchange rate as, "that rate which over a certain period of time keeps the balance of payments in equilibrium." Equilibrium exchange rate can be determined by two methods:

- The exchange rate between US dollars and Indian Rupees can be determined by demand for and supply of US dollars in India or by Indians. The price of US $ is fixed in Indian Rupees.
- The exchange rate between Indian Rupees and US dollars can also be determined by demand for and supply of Indian Rupees by Americans or in the USA. The price of Indian Rupee is determined in US dollars.

The prices are the same in both these methods.

Demand for Foreign Exchange

The demand for foreign exchange is determined by the country's:

- Import of goods and services.
- Investment in foreign countries (flow of capital to other countries), *i.e.*, establishment of an industry by Indians in the USA.
- Other payments involved in international transactions like payments of Indian Government to various foreign governments for settlement of their transactions.
- Other types of outflow of foreign capital like giving donations etc. The demand curve indicates the amount of foreign exchange demanded *(for example, US dollars)*. The demand curve is shown by DD in *Figure 4.3*.

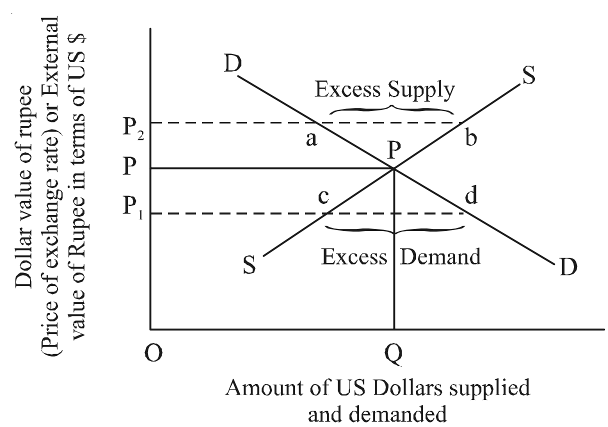

Fig. 4.3 : Exchange Rate Determination

Supply of Foreign Exchange

Supply of foreign exchange of a particular country (*i.e.*, US dollars) indicates the availability of foreign currency of a particular country to the country concerned (*i.e.*, India) in its foreign exchange market. The supply of foreign exchange includes:

- Country's exports of goods and services to foreign countries.
- Inflow of foreign capital.
- Payments made by the foreign governments to Indian government for settling their transactions.
- Other types of inflow of foreign capital like remittances by the Non-Resident Indians, donations received etc.

The supply curve of foreign exchange is shown by '*SS.*' The equilibrium exchange rate is determined at '*P*' where the demand curve '*DD*' intersects the supply curve '*SS*'. Both the supply of foreign exchange and demand for foreign exchange is '*OQ*' and the exchange rate is '*OP*'.

At price (exchange rate) OP_2, the supply of foreign exchange 'b' is in excess of demand, for the same (*i.e.,* 'ab'). At the price 'OP_1' the demand for foreign exchange 'd' is in excess of supply 'c' (*i.e.,* 'cd').

Increase in demand for foreign exchange, when the supply of the same is constant (or increase in demand is greater than that of supply) resulting in increase in price (*See Figure 4.4*).

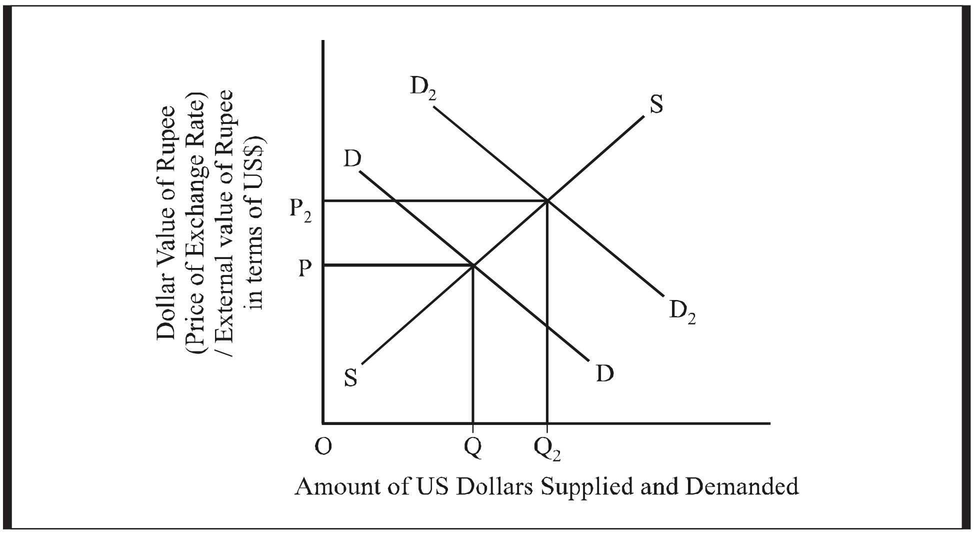

Fig. 4.4 : Exchange Rate Determination When Demand Increase > Supply Increase

The supply of foreign exchange is shown by 'SS', original demand is shown by 'DD' and increased demand is shown by 'D_2D_2'. The original quantity of foreign exchange (US \$) demanded is 'OQ' and the increase quantity of foreign exchange (US \$) demanded is 'OQ_2'. Equilibrium price is 'OP' and the new price is 'OP_2'. Thus, the increased demand for foreign exchange, when supply is constant, resulted in increase in price from 'OP' to 'OP_2'.

In contrast, increase in supply of foreign exchange, when the demand is constant (or increase in supply is greater than that of demand), resulting in decline in price (*See Figure 4.5*).

The original supply of foreign exchange is shown by 'SS' and the increased supply is shown by 'S_1S_1'. Demand is shown by 'OO'. The increased supply resulted in increase in quantity from 'OQ' to 'OQ_1' Equilibrium price is 'OP' and the new price due to increase in quantity is 'OP_1'. Thus, the price declined from 'OP to 'OP_1' consequent upon increase in supply. Thus, excess supply over demand resulted in decline price over the equilibrium price.

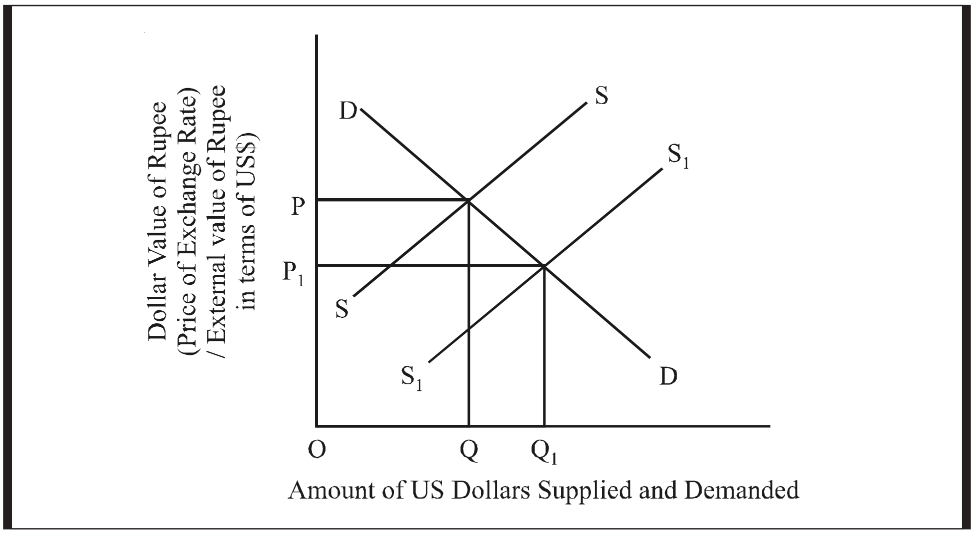

Fig. 4.5 : Exchange Rate Determination When Supply Increase > demand Increase

Increase in demand for US $ then that of supply of the same resulted in increase in the price of US $ in terms of Indian Rupee from Rs. 35 in 1997 to Rs. 45 in 2006. (1 US $ = Rs. 35 in 1997 and 1 US $ = Rs. 45 in 2006).

Thus the excess demand over supply results in the exchange rate higher than the equilibrium exchange rate and *vice versa* is true if the demand is less than the supply.

Having discussed the exchange rate determination, we now discuss the exchange rate policies. Exchange rate policy can be fixed exchange rate or flexible exchange rate.

Fixed and Flexible Exchange Rates

As discussed earlier, International Monetary Fund favours fixed exchange rate. Fixed exchange rate is also known as pegged exchange rate or par value. One of the objectives of the IMF include: to stabilise the exchange rates with proper safeguards whenever necessary.

On the other hand, exchange rate is purely determined by the market conditions of demand for and supply of foreign exchange. Flexible exchange rates are more prevalent in the market and open economies. The monetary authorities provide freedom to the market forces to determine exchange rates.

Fixed Exchange Rates

IMF member governments used to fix or determine exchange rates by pegging operations and/or by resorting to exchange control. Under this system, the governments used to fix the exchange rate and the central bank to operate it by creating 'exchange stabilisation fund.' The central bank of the country purchases the foreign currency when the exchange rate falls and sells the foreign exchange when the exchange rate increases.

Why do countries go for the Fixed Exchange Rate System?

The countries follow fixed exchange rates due to its advantages. They are:

- Fixed exchange rates ensure certainty and confidence and thereby promote international business.
- Fixed exchange rates promote long-term investments by various investors across the globe.
- Most of the world currency areas like US dollar areas and sterling pound areas prefer fixed exchange rates.
- Fixed exchange rates result in economic stabilisation.
- Fixed exchange rates stabilise international business and avoid foreign exchange risks to a greater extent. As such the small but international business oriented countries like the UK and Denmark prefer a fixed exchange rate system.

Despite these advantages, most countries of the world at present are not in favour of this system, though the IMF aimed at maintaining stable or pegged exchange rates.

Why are some countries against the Fixed Exchange Rate System?

As mentioned above, some countries are not in favour of the fixed exchange rate system due to its disadvantages. They are:

- Due to the problems with the fixed exchange rate system, IMF permits occasional changes in the system. This system is changed into 'managed flexibility system.' The managed flexibility system needs large foreign exchange reserves to buy or sell foreign exchange in order to manage the exchange rate. Maintenance of greater reserves aggravate the problem of international liquidity.
- Fixed exchange rate system may result in a large-scale destabilising speculation in foreign exchange markets.
- Long-term foreign capital may not be attracted as the exchange rates are not pegged permanently.

- This system neither provides the advantages of complete fixed rate system nor flexible exchange rate system. Here, we can recall the limitations of mixed economic system and Bernard Shaw's classical saying which says that:

  A young beautiful lady proposes to marry Bernard Shaw and offers the proposal by saying that our children will be intelligent like you and as beautiful as myself. Bernard Shaw, turns down the proposal by saying: Suppose our children would be ugly as myself and as idiots as yourself....
- The economic policies and foreign exchange policies of the countries are rarely co-ordinated. In such cases, the pegged exchange rate system does not work.
- Most of the economies in recent years are liberalised and globalised. These economies prefer flexible exchange rate system.
- Deficit of the balance of payments of most of the countries increases under a fixed exchange rate system as the elasticities in international markets are too low for exchange rate changes.

Due to these disadvantages, some countries prefer to have a flexible exchange rate system.

Flexible Exchange Rates

Flexible exchange rates are also called floating or fluctuating exchange rates. Flexible exchange rates are determined by market forces like demand for and supply of foreign exchange. Either the government or monetary authorities do not interfere or intervene in the process of exchange rate determination. Under this system, if the supply of foreign exchange is more than that of demand for the same, the exchange rate is determined at a low rate and *vice versa*. These market forces work on their own automatically.

Most of the countries in recent times are in favour of flexible exchange rates due to their advantages.

India followed fixed exchange rate system by pegging Rupee to the UK pound until August 1975. It resulted in import of inflation from the UK. Consequently, India dispensed written fixed exchange rate system and followed the flexible exchange rate system from September 1975. Now, the exchange rate of Indian Rupee is determined by the market forces. Similarly, Papua New Guinea has also dispensed with fixed exchange rate system 1981 and introduced flexible exchange rate system. A number of other countries like the USA, the UK, Australia, France and Japan follow flexible exchange rate system.

Advantages of Flexible Exchange Rates

Advantages of flexible exchange rates include:

- This system is simple to operate. This system does not result in deficit or surplus of foreign exchange. The exchange rate moves automatically and freely.
- The adjustment of exchange rate under this system is a continuous process.

- The system helps for the promotion of foreign trade.
- Stability in exchange rate in the long-run is not possible even in a fixed exchange rate system. Hence, this system provides the same benefit like the fixed exchange rate system for long-term investments.
- This system permits the existence of free trade and convertible currencies on a continuous basis.
- This system also confers more independence on the governments regarding their domestic policies.
- Solumen argues that this system tends to reinforce the effectiveness of monetary policy.
- This system eliminates the expenditure of maintenance of official foreign exchange reserves and operation of the fixed exchange rate system.

Disadvantages of Flexible Exchange Rates

However, this system is also not free from the disadvantages. The disadvantages of this system include:

- Market mechanism may fail to bring about an appropriate exchange rate. The equilibrium exchange rate may fail to give the necessary signals to correct the balance of payments position.
- It is rather difficult to define a flexible exchange rate.
- Under the flexible exchange rate system, the exchange rate changes quite frequently. These frequent changes result in exchange risks, breed uncertainty and impede international trade and capital movements.
- B.O. Sodersten claims that flexible exchange rates increase uncertainty for traders and have a dampening effect on foreign trade.
- Under the flexible rate system, speculation adversely influences fluctuations in supply and demand for foreign exchange.
- Under this system a reduction in exchange rates leads to a vicious circle of inflation.

Despite the advantages of fixed exchange rate and the disadvantages of floating exchange rate system, it is viewed that the flexible exchange rate system is suitable for the globalisation process. In addition, the convertibility also helps the floating rate system and the globalisation of foreign exchange process. Hence, we now shall discuss the convertibility of rupee.

(E) THE FOREIGN EXCHANGE MARKET

Meaning: Foreign exchange is the money of the foreign country in the form of notes and coins, foreign currency bank balances, bank notes, cheques, drafts, electronic money and any other forms. Foreign exchange market is physical, on-line and institutional structure through which money of one country is exchanged for that of any other country, at the rate determined either mutually or by market forces.

Foreign exchange transactions are completed either physically or on-line. A foreign exchange transaction is an agreement between a buyer and a seller that a fixed amount of lone currency will be delivered for some other currency at a specified rate and at a specified time.

Functions of Foreign Exchange Market

Functions of foreign exchange market include transfer of purchasing power between countries, credit for international business, and minimise exchange rate risks.

- **Transfer of Purchasing Power:** International business transactions between two countries or individuals or institutions are dealt in one currency. The individual or institution or country should have the currency in which the transaction takes place in order to make a purchase. Therefore, the foreign exchange market provides the currency in which the transaction is carried out, in order to enable the buyer to purchase the product/service. Thus, the foreign exchange market transfers the purchasing power.
- **Credit for International Business:** International business involves transfer of goods from one country to country. The importer can't pay for the goods until they are received. But the exporter can't export until he receives payment or guarantee for payment. Therefore, providing credit when the goods are in transmit is necessary. Foreign exchange market provides a source of credit in the form of instruments like bankers' acceptance, letters of credit and letter of guarantee.
- **Minimise Exchange Rate Risks:** There are a number of risks in dealing with foreign exchange due to fluctuations in foreign exchange rate in addition to political risks. Foreign exchange market transfers foreign exchange risk to others, who are willing to carry them through 'hedging'.

Nature of Foreign Exchange Market

Foreign exchange market is widespread throughout the globe, market participants are specialists, transactions involve immense volume and involvement of variety of transactions.

- **Widespread Geographically:** Foreign exchange market is widespread geographically. Foreign exchange transactions take place in all the countries in the world and in all geographical areas in each country.
- **All Time Operations:** Foreign exchange market carries the transactions 24 hours a day and 365 days a year. In fact, foreign exchange transactions take place every minute in one or the other part of the world. All the trading centres work 24 hours a day in view of varying time zones in various countries.
- **Market Participants:** Foreign exchange market consists of two levels viz., interbank or wholesale market and retail market. The participants in

the foreign exchange market include: bank and non-bank foreign exchange dealers, individuals and firms conducting commercial and investment transactions, speculators and arbitragers, central banks and treasuries and foreign exchange brokers.

Banks and non-bank foreign exchange dealers operate in interbank and client markets. They buy foreign exchange at a 'bid' price and sell at a higher price called 'ask' price and thus make a profit.

Individuals and firms conducting commercial and investment transactions include importers, exporters, international portfolio investors, MNCs, tourists and others. This category of parties use the foreign exchange market to facilitate the commercial transactions.

Speculators and arbitragers participate in foreign exchange market to earn profit by trading in foreign exchange rate changes. Arbitragers try to earn profit from simultaneous exchange rate differences in different markets.

Central banks and treasuries participate in the market to acquire and spend foreign exchange reserves and to influence the price in the market. Foreign exchange brokers/agents trade in foreign exchange on behalf of their principals, by charging a small commission for their service.

Size of the Market: The volume of foreign exchange traded in the foreign exchange market is very large. The volume of foreign exchange traded is estimated at US $ 1.5 trillion a day.

The Trading Mechanism

Foreign exchange market is an organisational selling within which various parties to trading buy and sell foreign exchange. Most of the transactions in the market involve the transfer in bank deposits and a small portion of the transactions involve transfer of currency. Most of the currencies are traded in the market. However, some currencies, which are vulnerable to political instabilities, economic uncertainties and inactive economic operations are not normally traded in the market. Foreign exchange markets mostly do not have organisational structure, centralized meeting place and formal requirements to participate. Banks normally engage in three types of foreign exchange transactions, *viz.,* spot, forward and swap.

(F) CONVERTIBILITY OF THE RUPEE AND ITS IMPLICATIONS

The term convertibility of a currency means that it can be freely converted into any other currency. It helps in the removal of quantitative restrictions on trade and payments on current account.

After the announcement of economic liberalisation in July 1991, Government of India announced partial convertibility of the Rupee from March 1, 1992, in order to integrate the Indian economy with the rest of the globe. Under this partial convertibility, 40% of the earnings were convertible in rupees at officially determined exchange rate and the remaining 60% of the exchange earnings were convertible in rupees at market determined exchange rate. Thus, 40% of the convertibility was announced.

Liberalised Exchange Rate Management System

A new system of exchange rate management was introduced with the introduction of partial convertibility of the rupee. Under this system 40% of current account transactions were conducted at the rate determined by the Reserve Bank of India and the remaining 60% at the market determined rate.

This system was introduced as a transitional arrangement towards unified exchange rate with current account convertibility.

Unified Exchange Rate

The Government of India, in March 1993, introduced a fully unified market determined exchange rate system. Thus, the unification of exchange rate and floating of rupee was started in 1993-94.

The exchange rate is now when determined based on demand for and supply of foreign exchange in the market.

Convertibility of the Rupee on Current Account

Convertibility on current account is defined as, “the freedom to buy or sell foreign exchange for the following international transactions:

- All payments due in connection with foreign trade, other current business including services and normal short-term banking and credit facilities.
- Payments due as interest on loans and as net income from other investments.
- Payments of moderate amount of amortisation of loans or for depreciation of direct investment, and
- Moderate remittances for family living expenses.”

Current account convertibility relates to the removal of restriction on payments relating to the imports and exports of goods, services and factors of income. Capital account convertibility refers to the removal of the restrictions on payments relating to the capital transactions like inflow and outflow of short-term and long-term capital.

- The first major step towards convertibility was the verification of the exchange rate.
- The next step in this direction is the removal of exchange restrictions on imports through the abolition of foreign exchange budgeting in 1993.
- The third step is announcement of relaxations in payment restrictions in case of a number of invisible transactions by R.B.I.

- The final step is announcement of full convertibility of the rupee on current account in August 1994 by accepting the obligation under Article VIII of International Monetary Fund.

The Implications of Convertibility

The implications of convertibility include:

- Now the authorised dealers are empowered to release exchange without prior approval of Reserve Bank of India.
- Exporters find it easy to transact the business.
- Many bureaucratic hurdles are eliminated in the process of obtaining foreign exchange for imports. Therefore, importers' job is simplified.
- More than 100 countries in the world allowed full convertibility of their currencies on current account.

Capital Account Convertibility

As discussed earlier, capital account convertibility refers to the removal of the restrictions on payments relating to the capital transactions like inflow and outflow of shortterm and longterm capital. After introducing the full convertibility on current account, Indian Government was contemplating to announce convertibility on capital account also. But, the crisis in south-east Asian nations, Brazil and Mexico made the Indian Government to shelve the proposal in cold storage.

The next important factor in the international finance is foreign institutional investors and global deposit receipts.

(G) FOREIGN INSTITUTIONAL INVESTORS

Foreign Institutional Investors (FIIs) are the foreign institutions like pension funds, mutual funds, investment trusts and portfolio managers Flls operate in a number of money and capital markets in the world.

According to the Regulations issued by the Government of India, Foreign Institutional Investors (FIIs), Non-Resident Indians (NRIs), and Persons of Indian Origin (PIOs) are allowed to invest in the primary and secondary capital markets in India through the portfolio investment scheme (PIS). Under this scheme, FIIs/NRIs can acquire shares/debentures of Indian companies through the stock exchanges in India.

The ceiling for overall investment for FIIs is *24 per cent* of the paid up capital of the Indian company and *10 per cent* for NRIs/PIOs. The limit is 20 per cent of the paid up capital in the case of public sector banks, including the State Bank of India.

The ceiling of 24 per cent for FII investment can be raised up to sectoral cap/ statutory ceiling, subject to the approval of the board and the general body of the company passing a special resolution to that effect. And the ceiling of 10 per cent for NRIs/PIOs can be raised to *24 per cent* subject to the approval of the general body of the company passing a resolution to that effect.

The ceiling for FIIs is independent of the ceiling of 10/24 per cent for NRIs/ PIOs.

The equity shares and convertible debentures of the companies within the prescribed ceilings are available for purchase under PIS subject to:

- The total purchase of all NRIs/PIOs both, on repatriation and non-repatriation basis, being within an overall ceiling limit of (a) 24 per cent of the company's total paid up equity capital and (b) 24 per cent of the total paid up value of each series of convertible debenture; and
- The investment made on repatriation basis by any single NRI/PIO in the equity shares and convertible debentures not exceeding five per cent of the paid up equity capital of the company or five per cent of the total paid up value of each series of convertible debentures issued by the company.

The Government of India issued the Regulations on Foreign Institutional Investors on November 14, 1995. According to these regulations foreign institutional investors (FIIs) may invest only in:

- Securities in the primary and secondary markets including shares, debentures and warrants of companies listed in a recognised stock exchange in India.
- Units of schemes floated by domestic mutual funds including Unit Trust of India, whether listed on recognised stock exchange or not.

Government approved joint ventures between domestic firms and FIIs in the following areas:

- Stock broking
- Merchant banking
- Asset management
- Non-banking financial sector.

These joint ventures are expected to introduce international practices and systems in Indian securities industry.

The number of FIIs registered with the Securities and Exchange Board of India (SEBI) increased from 10 in 1993 to 1046 in 2007. The investment by FIIs increased from US $ one million in 1992-93 to US $ 5114 million in 2006-07. Government liberalised its policy with regard to FIIs. Accordingly now the FIIs can invest in unlisted companies and in corporate and government securities.

(H) GLOBAL DEPOSITORY RECEIPTS

In order to enable the Indian companies to mobilise funds from the foreign countries, the Government of India allowed Indian companies satisfying certain conditions to access foreign capital markets through Euro issues of Global Depository Receipts (GDRs) and Foreign Currency Convertible Bonds (FCCBs).

"A depository receipt is basically a negotiable certificate, denominated in US dollars, that represents a non-US company's publicly-traded local currency (Indian Rupee) equity shares. Depository receipts are created when the local currency shares of Indian company are delivered to the depository's local custodian bank, against which the Depository Bank (like Bank of America) issues depository receipts in US dollars. The depository receipts may trade freely in the overseas markets like any other dollar denominated security, either on a foreign stock exchange, or in the over-the-counter market, or among a restricted group such as quantified institutional buyers."

The term global depository receipts indicates that the depository receipts are marketed globally rather than in any specific country or market.

Companies with good track record are allowed to issue GDRs. The companies are allowed to issue GDRs for investing money in the infrastructure projects including:

- Power
- Petroleum exploration and refining
- Telecommunications
- Ports
- Roads
- Airports.

(I) CAPITAL EXPENDITURE ANALYSIS

International business firms may have a variety and a number of capital expenditure proposals on hand. It would be very difficult for these companies to select the best project in terms of feasibility. Capital expenditure analysis is necessary in order to select the most profitable project. Capital budgeting technique is useful in selecting the most appropriate project, in addition to the other techniques.

According to Quirin, "Capital expenditure is the exchange of present expenditure for future benefits".

According to Kohler, "Capital expenditure is an expenditure intended to benefit future periods in contrast to a revenue expenditure which benefits a current period and to a capital asset. The term is generally restricted to expenditure that add fixed assets units or that have the effect of increasing the capacity, efficiency, span of life or economy of operation of an existing fixed asset."

Two types of investments are necessary for establishing a business unit in a foreign country. They are :

- Capital Investment/Expenditure and
- Current Investment/Working Capital

Capital investment is also known as capital expenditure. The process of incurring capital expenditure is made by using capital budgeting techniques. The amount on capital expenditure allocation depends on the MNCs overall objectives.

Features of Capital Expenditure

Capital expenditure has the following features:

- Huge capital
- Associated with risk
- Decisions are made for longer periods
- Irreversible decisions
- Benefits are derived over a long period
- Requires rational decision-making process.

1. **Investment on Capital Expenditure Requires Huge Amount of Capital:** Investment on land, building, machinery, plant, initial advertising is called capital expenditure. The amount of finance required to buy these capital assets is huge and financed through longterm sources like equity capital, debenture capital and longterm loans from developmental banks and financial institutions.
2. **Associated with Risk:** Capital expenditure is exposed to different types of risk as the investment is made for longer periods. *For example*, investment made in the manufacturing of electronic typewriters could not be recovered due to the invention of computers. *Similarly*, investment made in the production of pagers is not recovered due to the invention of cell phones. Therefore, technological changes, changes in customer preferences, political factors of foreign countries and the like, lead to the involvement of risk.
3. **Decisions of Capital Expenditure are made for Longer Periods:** The decision on capital expenditure is made once in a life time of business. Decisions on such investment contribute for the achievement of organisational objectives.
4. **Irreversible Decisions:** Decisions once made on capital expenditure cannot be reversed. *For example,* General Motors invested US $ 2,000 million for the production of small cars. It could produce the small car, but the cost of production was more than that of the price of Japanese car. Ultimately, General Motors could not sell the car and shelved the project.

5. **Benefits are Derived over a Longer Period:** The benefits from the capital expenditure cannot be derived immediately.
6. **Rational Decision-Making Process:** Due to the involvement of risk, decisions are irreversible and the benefits are derived in the long-run, capital expenditure decisions are made by the top management. The finance manager provides the information regarding financial viability of the project and all other managers provide the information regarding the viability of the project from their view point. Top management integrates all these and makes the decisions more rationally.

These features of capital expenditure suggest that it should be incurred in a planned and rational way. Therefore, the managers of MNCs plan for capital expenditure proposals.

Planning for Capital Expenditure Proposals

Careful analysis of the different phases of business cycle assist in finding the requirements of capital expenditure. These are :

Initial Stage - Research and Development: At the initial stage, the MNCs are required to incur expenditure for research and development. They invest in market research and product research. In fact, the changing technology and market conditions require continuous investment at the later stages also.

Growth Stage - Expansion: Normally, MNCs would like to grow, expand their operations throughout the globe. Therefore, the management of MNCs continuously invest in machinery, land and buildings even at this stage.

Saturation Stage - Diversification Stage: MNCs after consolidating their position in the growth stage reach the maturity or saturation stage. At this stage, MNCs prefer to diversify their activities. *For example*, Coca-Cola in India diversified its activities and started producing mineral water under the brand 'Kinley'. MNCs have to make further investments in plant, machinery etc., at this stage also.

Decline Stage: After the maturity stage, the next logical stage is declining stage. At this stage the MNCs would like to turn around the project either by modernising the plant and machinery or by introducing the latest technology or by replacing the existing machinery. Therefore, the MNCs are required to incur capital expenditure at this stage also.

The finance managers of MNCs evaluate the capital expenditure proposals very carefully due to the involvement of huge amounts of finance. They follow certain principles in this regard.

Principles of capital expenditure

Basic principles of Capital Expenditure proposals are:

Principle of Cash Flow: Cash flow is generally referred to as the operating income generated by the company during a particular period.

Incremental Principle: Incremental cash flow is based on the principle of estimating the cash flows by considering the investment with the project cost and without the project cost in order to know the incremental income from a particular project.

Long Term Funds Principle: The investment on capital expenditure is invariably for long term. Therefore, the MNCs uses the long-term funds like share capital, debenture capital and long term loans for financing the capital expenditure projects.

Interest Exclusion Principle: The interest component as longterm funds is excluded while calculating the cash flows.

Post Tax Principle: The MNCs finance managers have to deduct the amount of tax while estimating the cash flows.

Having discussed these principles, now we shall discuss the methods of appraisal of Capital Budgeting.

Methods of Appraisal of Capital Budgeting/Capital Expenditure

Methods of Appraisal of Capital Budgeting or investment proposals are broadly classified into two. They are :

1. Traditional Methods and
2. Discounted Cash Flow Methods

They are further classified as :

Traditional Methods

Pay-back Period Method	Pay-back Profitability Method	Accounting Rate of Return Method

Discounted Cash Flow Methods

The Net Present Value Method	Internal Rate of Return Method	Profitability Index Method

Now, we shall discuss each of these methods.

Traditional Methods

Pay-back Period Method

Pay-back period refers to the period in which the project is expected to generate the necessary revenue to recover the initial investment.

$$\text{Pay-back period} = \frac{\text{Original investment of the project}}{\text{Annual cash flow of the project}}$$

The MNCs select the project with the lowest pay-back period from among the alternative projects.

Though this method is simple and provides an easy way to evaluate the project, it does not take the time value of money. Further, this method does not consider the earnings of the project after the pay-back period is over.

To overcome these limitations, pay-back profitability method is evolved.

Pay-back Profitability Method

This method considers the cash flows during the economic life of a project, as the entire amount of earnings or cash flows must be considered to evaluate a project. This method is also called the post pay-back profitability.

$$\text{Post Pay-back Profitability} = \begin{array}{c}\text{Total cash flow during the}\\ \text{economic life of a project}\end{array} - \text{Original Investment}$$

The MNCs select the project with the highest post pay-back profitability under this method.

These two methods ignore the tax and depreciation. Another method is evolved to consider tax and depreciation *i.e.*, Accounting Rate of Return Method.

Accounting Rate of Return Method

This method is based on conventional accounting concepts. Under this method, profit after depreciation and taxes during the entire life of the project are considered

$$\text{Accounting Rate of Return} = \frac{\begin{array}{c}\text{Average Annual Income after}\\ \text{Tax and Depreciation}\end{array}}{\text{Average Investment}} \times 100$$

The MNCs select the project with the highest accounting rate of return from among those projects with more than or equal to the minimum acceptable accounting rate.

Though this method is superior to the other two methods in utility, it ignores the time value of money. Discounted cash flow methods take the time value of money into consideration.

Discounted Cash Flow Methods

These methods take the time value of money. These methods are built on the principle that the money received today is more valuable than the money received after a year. This is because the money received today earns interest or profit or dividend. It is important to consider the timing of returns on investment in evaluating investment projects in various countries.

Discounted Cash Flow (DCF) technique involves the following methods:

- Calculation of cash inflow and outflows over the entire life of the asset
- Discounting the cash flows by a discount factor

- Aggregate the discounted cash inflows and compare the total so obtained, with the discounted cash outflows.

The two important DCF methods are:

- The Net Present Value Method
- Internal Rate of Return Method.

Net Present Value Method: This method considers the impact of time value of money. An appropriate interest rate should be selected to discount the cash flows. This rate is referred to as cost of capital or discount rate. The present value of the future cash inflows is calculated by using this discount rate. The present value of the future cash inflows is compared with the original investment. If the net present value (NPV) is greater than the original investment, the MNC can accept that project, otherwise it can reject the project.

Internal Rate of Return Method: Internal rate of return is that rate at which the sum of discounted cash inflows equals the sum of discounted cash outflows. MNCs can accept the project whose internal rate of return is greater than or equal to the minimum required rate of return.

Though the MNCs can make investment decisions using capital expenditure analysis and capital budgeting techniques, such decisions need not be reliable due to the involvement of different kinds of risks in the international business.

Hence, we now study the different kinds of international risks, their consequences and management of international risks.

(J) INTERNATIONAL RISK MANAGEMENT

So far, we have discussed the capital expenditure analysis in making foreign investment. But it involves different kinds of risk.

International business and financial decision-making require an understanding and consideration of risk factors. In fact, both domestic and international business involve risk due to uncertainty of amount of gains that will be available from a business project. Added to this, foreign investment involves a number of unique risks which would affect international finance immediately and international business at a later stage. These risks include :

- Political Risks
- Commercial Risks
- Exchange Control Restrictions on Remittances
- Differing Tax Systems
- Sources of Funds
- Exchange Rate Fluctuations, and

- Different Stages and Rates of Inflation
- Risks of Non-payment

Now, we shall discuss each of these stages

Political Risks

Exporting to Pakistan by India is not so easy as exporting to Russia or to Bangladesh by India. Pakistan accepted Indian imports when Nawaz Shariff was the Prime Minister and it rejected the same when Musharaff Parveez became its Chief Executive Officer (now President of Pakistan). *Similarly*, the USA encouraged software imports from India, when Mr. Bill Clinton was its President, but the same is not the case after Mr. Bush has become its President. These incidents are the examples of political risks.

Political risks are the hurdles or hindrances created by the host country. These hurdles include:

- Remittances of profits
- Restrictions on the types of activities of MNC
- Restrictions on transferring activities
- Imposing Quotas on imports
- Restrictions on employing expatriates
- Nationalising the assets of the business. *For example,* Zimbabwe recently nationalised the assets of foreign companies.
- Looting of the stock during internal disturbances. *For example*, stocks of Indian firms were looted in recent internal disturbances in Fiji.

These political risks enhance the risk of foreign investment due to degree of uncertainty of return. Hence, business houses prefer to invest in friendly countries.

Commercial Risk

The business houses estimate demand for products and services in foreign countries before actually making investment. *For example*, Whirlpool estimated the demand for its Washing Machines in Indian market and started marketing the product in India after liberalisation. But, at a later stage it found that the actual sales volume is far less than the estimated demand. Same is the case with Pepsi and Coca Cola in India. Such risks are called commercial risks. These risks are due to :

- Decline in demand due to decline in income
- Decline in demand due to the cultural variation
- Decline in demand due to patronage of the domestic products
- Due to change in the customer taste.

The next one is the Exchange Control Restrictions on Remittances.

Risks due to Exchange Control Restrictions on Remittances

Eritrean Government during 1998 initially imposed the restriction that Coca Cola company should not remit more than 50% of its profits to its parent company. *Similarly*, the Taiwan government imposed the restriction that the MNCs should not take more than 75% of their assets back. Such restrictions are called exchange control restrictions on remittances. The parent company should consider these issues while investing in foreign countries.

Risks due to Differing Tax System

China imposed only 5% tax on the incomes of foreign companies established in its Special Export Zones (SEZS), whereas Indian tax rate is more than that applicable to domestic companies. UK's tax rates are higher than those of the USA. In fact, net income of foreign subsidiaries is taxed higher than that of domestic companies. *Similarly*, the Afghanistan government goes on increasing these rates in case of foreign companies. Therefore, the business manager has to select the best country where these risks are low.

Risks of Sources of Funds

Malaysia encourages the foreign companies to mobilise funds from the local capital market whereas Eritrea imposes the condition that 50% of the capital of the MNCs subsidiary should be provided by the local investors. In fact, Indian government also imposed such a condition. But it liberalised it recently.

In fact, some countries impose the condition that capital should not be mobilised from specific countries.

Risks due to Exchange Rate Fluctuations

It is quite common that the exchange rates fluctuate very often. The fluctuations are mostly in favour of hard currencies and the advanced countries. And the risk is more in case of developing countries. Therefore, the MNCs should take into consideration the risks of exchange rate fluctuations while investing in developing countries.

Risks of Different Stages and Rates of Inflation

Inflation stages and rates vary from country to country. Normally, the inflation is in the first stage in underdeveloped countries and it is in growth stage in developing countries while it is in boom stage in advanced countries. Inflation was in boom in the UK during 1975 whereas it was in the initial stage in India. But the impact of UK's inflation on India pushed India's inflation to the growth stage. Then, we delinked our Rupee from UK's Pound. This rate of inflation affects global business.

Risk of Non-Payment

An exporter mostly faces the risk of non-payment. *For example,* a USA company exported fans to an importer in Kenya. The US exporter failed to collect the money as he could not locate the importer after two years. Thus exporter faces the risk of non-payment.

Therefore, the business manager has to manage the risks in order to carry out the business smoothly.

Risk Management

The MNCs have to manage the risks in order to reduce the consequences and the risks. Techniques of risk management include :

- Maintaining sound diplomatic relations with other countries.
- Avoiding investment in enemy countries
- Estimating the demand for the product in foreign countries
- Insuring the various business operations
- Getting the benefits from the institutions like Export Credit Guarantee Corporation
- Getting refinance facility.

POINTS TO BE REMEMBERED

- The exporter prefers to have home currency or hard currency while the importer prefers to have his home currency for settlement of international transactions.
- Methods of payments for imports include: payment in advance, open account, documentary collection, letters of credit, capital cards and counter-trade.
- The market intermediaries of foreign exchange market include: exchange banks, bill brokers, acceptance houses, and central bank of the country.
- IMF favoured fixed exchange rates. Fixed exchange rate is also known as pegged exchange rate. Developing countries prefer fixed exchange rates.
- Flexible exchange rates are also called floating or fluctuating exchange rates. Advanced countries prefer flexible exchange rates.
- Convertibility of the Rupee on current account helps in rapid integration of Indian economy with the rest of the globe.
- Government of India shelved the poposal of convertibility of the Rupee on capital account.
- FIIs and GDRs made a remarkable impression on Indian financial market.
- FDI is more beneficial to the host country.
- Capital expenditure analysis helps to make international investment decisions.
- Global business risks include political, commercial, exchange rate fluctuations etc. These risks can be managed by maintaining sound diplomatic relations, estimating the demand for the products in foreign countries accurately and the like.

KEY WORDS

- Foreign Currency
- Documentary Collection
- Credit Cards
- Sight Bill of Exchange
- Foreign Exchange
- Convertibility of the Rupee on Current Account
- Foreign Institutional Investors
- Foreign Direct Investment
- Capital Expenditure Analysis
- Open Account
- Letter of Credit
- Counter-trade
- Time Bill of Exchange
- Pegged Exchange Rates
- Unified Exchange Rate
- Convertibility of Rupee on Capital Account
- Global Deposit Receipts
- Global Business Risk

QUESTIONS FOR DISCUSSION

1. What are the distinct issues involved in international business agreements?
2. How do you determine exchange rates? What are the advantages and disadvantages of fixed exchange rate system?
3. What are the advantages and disadvantages of flexible exchange rate system?
4. What are the implications of convertibility of the Rupee on Indian economy?
5. Explain the impact of FIIs and GDRs on Indian economy.

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Unit Five

INTERNATIONAL MARKETING

CHAPTER OUTLINE

(A) INTRODUCTION

Most of us have already studied a course in Marketing. We also know various activities of marketing. However, we briefly discuss what marketing is before we proceed.

Marketing is "the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchange that satisfy individual and organisational objectives" Extension of these activities across the globe is referred to as International Marketing. Companies entering into international markets must deal with varying economic, social, cultural, political and legal environments and advertising media and distribution channels. *For example, one Indian Detergent Powder Manufacturing Company entered Saudi Arabia. It presented the same Indian advertisement in Saudi Arabia by changing the language. This advertisement indicates the sequence of operations. The first operation is the detergent powder mixed in the water and the dirty clothes are soaked in the water and the second operation is brushing the clothes, the third operation is getting clothes out of the water. The advertisement shows that the clothes become clean and bright when they are removed from the water. This advertisement has given the reverse view to the people of Saudi Arabia. As such the company could not sell its product.*

One of the Nike's advertisement features a coach telling his players "visualize your opponent as your worst enemy." This advertisement was banned by New

Zealand's regulators for being too violent. *Similarly,* they banned Coca Cola's advertisement featuring aboriginal dances for being culturally insensitive.

In addition international marketing managers capture synergies by efficient co-ordination of the markets. Environmental factors in different countries make the marketing different from one country to another country. Hence, we have to study International Marketing although we have studied a course on marketing.

Domestic marketing managers mostly go for standard products. But a standard product may not be acceptable to the customers of a foreign country. Hence, international marketing managers have a dilemma whether to standardise the product or customise it.

Standardisation *vs.* Customisation

The days of standardisation are slowly getting vanished due to the different tastes and preferences of and increased purchasing power of the customers of the different countries. Added to this, the increased competition forced the companies to go for designing, producing and selling the product based on the customer taste rather than simply selling what it can produce. *For example*, readymade garments, automobiles, and communication instruments are being produced based on customer taste (customisation).

International marketing managers gave three options regarding the trade-off in between standardisation and customisation in marketing mix, *viz:*

- **Ethnocentric approach:** Under this approach companies market the products in various countries in the same way they do domestically. *(Box 5.1)*.

BOX 5.1 FOOD BRINGS THE WORLD TOGETHER

Because of McDonald's, hamburgers and Big Macs are a common sight around the world. In the United States, Mexican, Italian, Chinese, and even Thai foods have become or are becoming mainstream. It must have been quite strange some sixty years ago for anyone in the United States to predict that flat bread with tomato sauce and melted cheese on it would become mainstream. Nowadays, that flat bread (pizza) seems to be more American than Italian. Perhaps, following pizza in the same direction is *pho*, the Vietnamese beef noodle soup. Also *nuoc mam*, the Vietnamese and Thai fish sauce, is becoming more like soy sauce in terms of acceptance. The adaptive nature of American culture makes it easy for the foods and eating customs of immigrant groups to get assimilated into society.

Malaysians are used to fast food offered by KFC and McDonald's and are thus not averse to new American concepts in food. Newer chain restaurants cater to a more affluent clientele. Kenny Rogers Roasters, Chili's Grill & Bar, and T.G.I. Friday's offer their own versions of an American culture, and they all have stuck closely to their U.S. formulas. Friday's imports 70 per cent of its food including beef, cheese and potatoes. However, it has made one concession to Malaysian taste by adding a bottle of chilly sauce next to Heinz ketchup on a table. Likewise, Chilli's has kept its American menu intact with one exception: replacing pork ribs (which are inappropriate in mostly Muslim Malaysia) with beef ribs. While its customers have complained that the portions are too large, Chili's feels that it must keep that part of the culture. Besides, Malaysian customers can simply order a few different dishes and share them the local way.

KFC provides another good illustration of the adaptation process. In Japan it is necessary to have a Shinto priest periodically conduct mass funerals for the firm's millions of chickens. The restaurant's menu also has been changed. In addition to serving French fries instead of mashed potatoes and gravy, KFC sells chicken sandwiches and fish and chips. Another one of its products is *yakitori* (chicken in broiled and skewered bite-size chunks). Several products require reformulation as well. The company cuts out half of the sugar from the salads, because the Japanese like their salads to be tart. The firm's corn-on-the-cob is the three-inch piece, which is two inches less than the U.S. version, in order to satisfy the local preference of a lot of little things. For the Malaysian market, the company has even had to change its cooking method. Because Malaysians consider firm chicken to be fresh and soft chicken to be frozen. KFC cooks its chicken to firm texture instead of the standard soft texture.

Source : "On Finding pho, and Other Great Vietnamese Eats," *San Jose Mercury News*, 23 March, 1994; and "If Food is the Universal Language, Yuppies in Malaysia say, T.G.I.F," *The Wall Street Journal*.

- **Polycentric approach:** Under this approach the company customises the marketing mix to meet the taste, performance and needs of the customers of each international market.

BOX 5.2 A GLOBAL PRODUCT

Reader's Digest is perhaps the world's most global magazine. The publication has remained unchanged and has been successful despite changes of culture. The magazine has endured for decades, earning the distinction of being the only mass-circulation, general-interest magazine that has survived the advent of television. The popularity of this largely sandardised medium is confirmed by the 100 million people who read the magazine's forty-seven editions in nineteen languages. It has a worldwide circulation of more than twenty-eight million. Its latest addition is the Thai-language edition which was introduced in 1991.

Reader's Digest has always used the same formula for all markets: the same upbeat editorial format, with the same folksy illustrations for the magazine's back cover in all of its editions. The key to its success in Eastern Europe is its formula for mixing feature editorial from the United States and international sources with local stories. When it entered Poland in 1994, Reader's Digest Association set up a wholly owned subsidiary to publish Reader's Digest Wybor. Its full-page advertisement in the New York Times proclaimed: "Hello Poland! The newest local edition of the world's most global magazine." According to the company, "the key for us is to have local people manage the operations and to become a local company."

Source : "Reader's Digest Enters Polish Market: To Build Prospect Files through Promos,".

- **Geocentric approach:** Under this approach the company analyses the taste, preference and needs of the customers in all foreign markets and then adopts a standardised marketing mix for all the foreign markets. *(See Box 5.2)*. Coca-Cola adopted this strategy by selling its popular soft drink with the same content, packaging, branding and advertisement themes world wide. Whirlpool designs a world washer–small, stripped-down automatic washing machine for Mexico, Brazil and India. However, it modified its product for the Indian market to wash the delicate sarees.

Exhibit 5.1 presents advantages and disadvantages of Standardised Marketing Mix and Customized Marketing Mix. Having discussed the customised *v.* standardised marketing mix we now study each of the aspects of marketing mix.

EXHIBIT 5.1 ADVANTAGES AND DISADVANTAGES OF STANDARDISED AND CUSTOMISED INTERNATIONAL MARKETING

Standardised International Marketing	
Advantages	***Disadvantages***
1. Reduces Marketing costs. 2. Facilitates centralised control of marketing. 3. Promotes efficiency in R & D. 4. Results in economies of scale in production. 5. Reflects the trend toward a single global market place.	1. Ignores different conditions of product use. 2. Ignores local legal difference. 3. Ignores differences in buyer behaviour patterns. 4. Inhibits local marketing initiates. 5. Ignores other differences in individual markets.
Customised International Marketing	
Advantages	*Disadvantages*
1. Reflects different conditions of product use. 2. Acknowledges local legal differences. 3. Accounts for differences in buyer behaviour patterns. 4. Promotes local marketing initiatives 5. Accounts for other differences in individual markets.	1. Increases marketing costs. 2. Inhibits centralised control of marketing. 3. Creates inefficiency in R & D. 4. Reduces economies of scale in production. 5. Ignores the trend toward a single global market place.

Source : Ricky W. Griffin and Michael W. Pustay, op. cit., p. 590.

International Marketing Mix – 4 Ps of Marketing

The international marketing mix consists of 4 Ps *viz.,*

- Product
- Price
- Place
- Promotion.

Figure 5.1 presents the perspective of international marketing. Now, we study the product.

- Product
  1. Product Development
  2. Product Life Cycle
  3. Branding Decision
  4. Packaging Decisions
- Price
  1. Pricing Decision
  2. Pricing Policies
  3. Factors Affecting International Pricing
  4. Price Quotations
  5. Dumping
  6. Counter Trade
- Place
  1. Direct 6Selling
  2. Indirect Selling/Market Intermediaries
- Promotion
  1. Advertising
  2. Personal Selling
  3. Sales Promotion
  4. Public Relations

Fig. 5.1 : International Marketing – A Development

(B) PRODUCT

A product is something both tangible and intangible. The tangible products can be described in terms of physical attributes like shape, dimension, components, form, colour, etc. The intangible products include various services like merchant banking, mutual funds, insurance, consultancy, air travel etc. However, sometimes both tangible and intangible are combined to give a total product. *For example*, a German company exports turn key projects (Technology, Machinery, expertise and service) to the USA and developing countries. The global markets must see the total product which includes tangible and intangible.

The study of product in the international market includes:

1. Product Development
2. Product Life-cycle
3. Branding Decisions
4. Packaging Decisions.

1. PRODUCT DEVELOPMENT

Figure 5.2 presents the stages of product development.

There are six stages of the product development.

(i) Generation of a Product Idea.

The development of Salt-Cum-Sweet Biscuits concepts in one biscuit company is developed by an accident of removing the divider by an employee.

Similarly, a 3M company chemist, after spilling some liquid on his tennis shoes, found that they had become capable of repelling water and dirt and that is how scotchgard fabric protector was born.

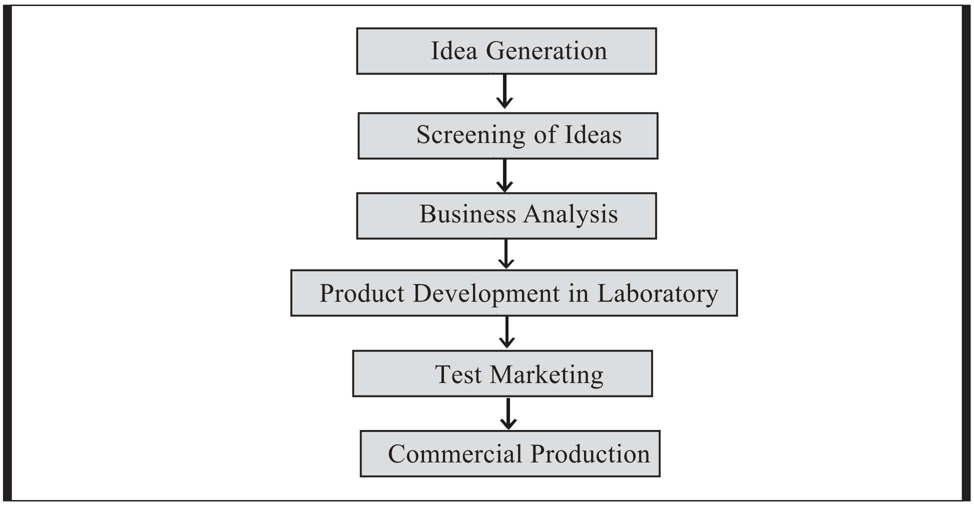

Fig. 5.2 : Stages of Product Development

(ii) The second stage involves the *screening of ideas* regarding their feasibility.

(iii) The third stage involves *business analysis* to estimate the product features, cost, demand and profit.

(iv) The fourth stage involves *development of the product* by laboratory, technical, production personnel.

"The Goldstar company engineers developed a distinct Refrigerator which can keep a Korean's National Dish (kimchi) fresh and odourless for a long time. This product was an instant hit and helped Goldstar to regain the top position which it had lost to Samsung in South Korea in the late 1990s.

(v) The fifth stage involves *test marketing*.

(vi) The sixth step is *realising the product* as full scale.

Market Segmentation: American markets give least importance to market segmentation in this global business. The main purpose of the market segmentation is to satisfy the customer needs more precisely. Market segmentation helps to enter the foreign markets in a phased manner. The success of the Japanese in entering the

U. S. market is attributed to this principle.

Product Positioning: Product positioning attempts to occupy an appealing space in a consumer's mind in relation to the space occupied by other competitive products. *For example, Bisleri Mineral water in India, Perrier — the French Mineral water, Mercedes-Benz for the wealthy, Maruti for the middle income, Xerox photocopy rather than Canon photocopy, Mc Donalds etc., have positioned effectively.*

Product Adoption: Product to be adopted in a foreign market must demonstrate five factors. They are:

- Relative advantage over existing alternatives.
- Product's cleanliness and sanitation are accepted in rich countries.

Compatible with local customs and habits: Refrigerators find a small market in Asia where people prefer fresh food. Japanese developed the technology to their life styles but they don't change their life style towards technology. The electrical kotatsu (foot warmer) is a traditional form of heater in Japan. New kotatsu are equipped with a temperature sensor and microcomputer to keep the interior temperature at a comfortable level. Japanese automobiles have these factors whereas U.S. automobiles lack this facility.

Observism: If the product is used publicly, the others can observe the product. Blue Jeans, watches, woollen coats etc. have this character. Similarly, refrigerators and TVs are placed in drawing rooms in Asian countries to enhance the observability.

Complexity: Product will have slow market acceptance if the product's qualities are difficult to understand.

2. PRODUCT LIFE CYCLE

The concept of life cycle of a human being, a product or a business firm either domestic or global is well established. The product life cycle concept generally indicates that, a product starts with a beginning or introduction stage and passes through the stages of growth, maturity and eventually disappears from the market in its declining stage.

The stages of product life cycle are:

(a) **Introduction stage:** In this stage, the product is initially introduced in the market. The product normally has low sales, other features of this stage include high cost (per unit) of sales, low competition and low profits or losses.

(b) **Growth stage:** During this stages, the product gains awareness and acceptance by the customers. The features of this stage include: fast growth in sales, profits and competition. Market segmentation and introduction of other models or sizes are the other features of this stage.

(c) **Maturity:** Product acceptance, sales and profits are at the peak stage and are stabilised at this stage. The competition is intensified at this stage. Profits start declining due to severe competition.

(d) Extension stages: The progressive companies at this stage introduce new models, new sizes, designs etc., in order to extend the maturity stage and/or to get another growth stage. The extension stages are characterised by slow growth of sales and profits.

(e) Decline stage: Development of new products, change in the existing product design, improving the quality etc., by the competitors make the customers to shift from this product to the competitor's products. In addition, the new technology brings substitute products with more value. *For example,* typewriters are replaced by computers. MS Office software replaced Wordstar and other languages. The stage is characterised by poor sales, losses, etc., which force the company to withdraw the product from the market.

The purpose of the study of product life cycle is to know the stage of the product or portfolio or business in its life cycle, understand its features in order to formulate appropriate strategies. The concept of Product Life Cycle (PLC) does not provide a basis for forecasting the volume or growth rate of sales and the timing of shift from one stage to the another. However, the stages of product life cycle of the same product vary from country to country. *For example*, the Aiwa TV is in declining stage in Japan but it is in introductory stage in Morocco. In fact, the companies go on modifying the product design by adding the value, features and the like. It results in extending each stage of the PLC. The extended PLC is presented in *Fig. 5.3*.

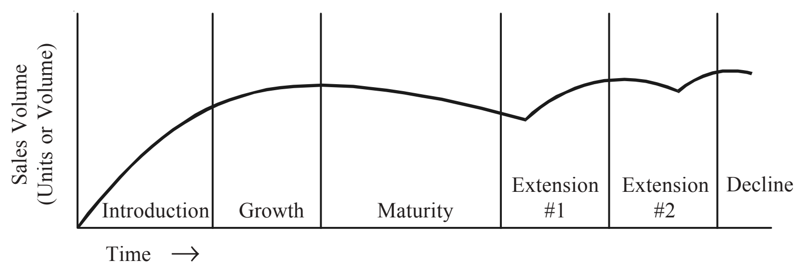

Fig. 5.3 : Extending the Product Life Cycle

Now, we shall discuss international product life cycle.

International Product Life Cycle

As we have discussed in *Chapter 2*, the theory of comparative cost advantage is a pure theory based on unrealistic assumption. Raymond Vernon discovered the international product life cycle model, which is in contrast to the comparative cost advantage theory. International product life cycle model is based on empirical actual pattern of trade. This model explains the relationship between the product life cycle trade and investment.

International product life cycle model explains:

- High-income, mass-consumption countries initially export, and later import the product as they lose their export markets.
- Later, the other advanced countries shift from an importing country to an exporting country.
- After some time, even the less developed countries shift from the status of importing country.
- New products are initially introduced in high-income countries/markets as the latter offer high potential demand.
- Initially products are produced where they are sold.
- Mostly product inventions take place in high-income countries.
- Entrepreneurs in middle-income countries take advantage of low cost of labour and other factors of production in the production of new products.
- Market stabilises when the product reaches maturity, the design, technology and markets stabilise.
- Production from low-income countries displaces the production of the high-income countries due to the cost advantage.
- Companies of high-income countries shift to low-income countries to take the advantage of low cost factors of production.

  Figure 5.4 presents the stages of international product life cycle.
- These companies gain the ownership and control over the production of low-income countries.
- The producers of low-income countries produce and sell higher volumes due to the low cost of production and price. Further, these producers also export in higher volumes due to heavy demand, consequent upon low cost of factors.
- Low-income countries export to high-income countries and compete with the industries of high-income countries who enjoyed monopoly at the initial stage of the cycle.
- With this stage, cycle completes its turn. Textiles is an example of this cycle. This product has gone through the complete cycle for the investing country (UK), other developed countries and finally the developing countries. *Similarly*, electronics industry passed through all the stages. This product shifted from the USA to Japan, to Korea and to India.

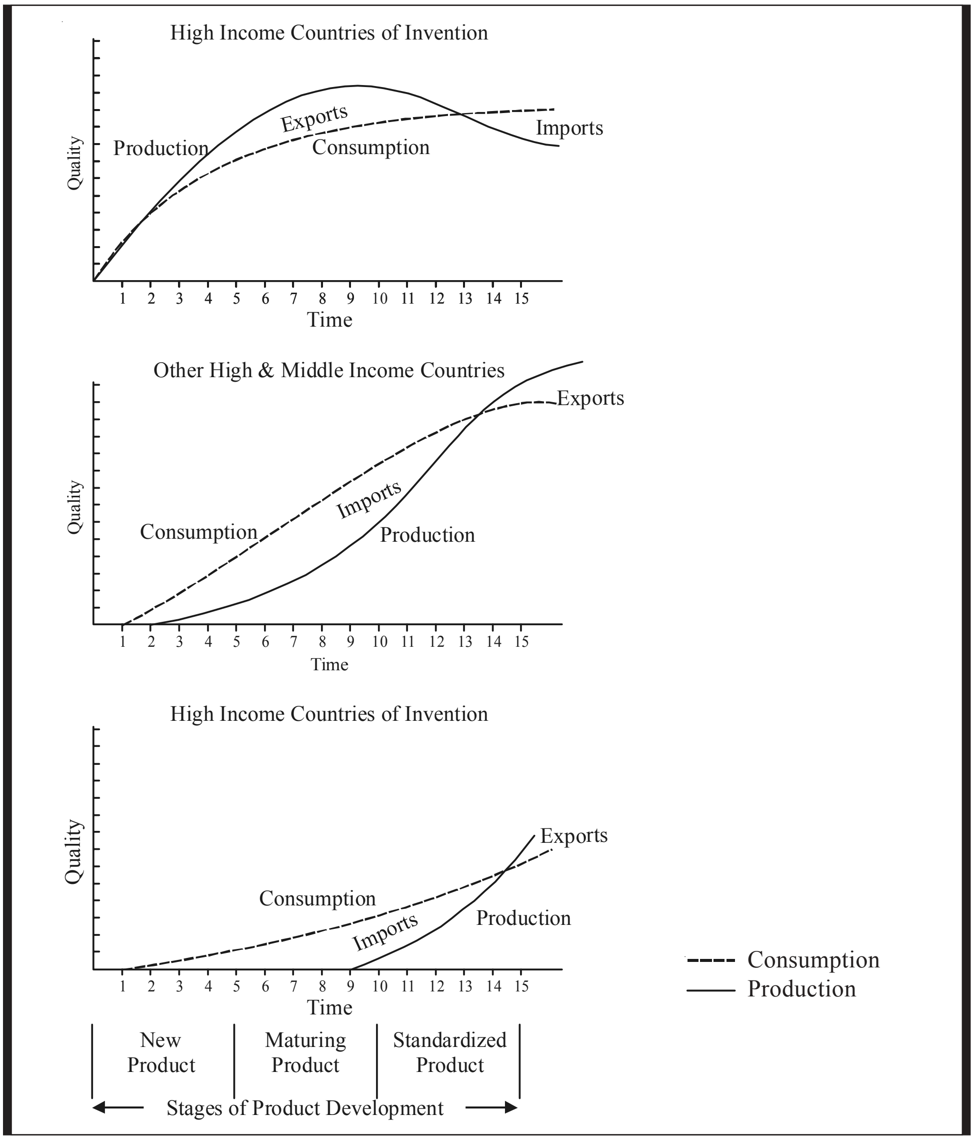

Fig 5.4 : International Product Life Cycle

Source: Warren J. Keegan, op. cit., p. 40.

Stages of International Product Life Cycle

Stages of international product life cycle include:

- **Stage Zero: Local Innovation:** The product in this stage is a familiar product in the local market. Product innovations take place mostly due to the changing wants of the local people.
- **Stage 1: Overseas Innovation:** After a product is successful in the domestic market, the producer desires exporting it to the foreign markets due to excess production compared to its demand in the domestic country.

- **Stage 2: Maturity:** The development of the product reaches the peak stage even in foreign markets. The producer modifies it and develops it based on taste and preference of the customers in foreign markets. The producer exports the products even to less developed countries in this stage.
- **Stage 3: World-wide Imitation:** The local manufacturers in various foreign countries start to imitate the popular foreign products. They modify those products slightly based on the local needs and produce the same at less cost and sell them at cheaper prices.
- **Stage 4: Reversal:** Competitive advantage of innovative or original manufacturer disappears at this stage as producers in many foreign countries imitate the product, develop it further and produce it at less cost. This stage also results in product standardisation and competitive disadvantage. The product at this stage does not have to be either capital intensive or technology intensive, but it becomes labour intensive — a strong competitive advantage possessed by developing countries.

Models of International Product Lifecycle

There are two models in introducing products in different countries *viz.*, trickle-down approach and shower approach.

Trickle-Down Model

Figure 5.5 shows the "trickle-down" model of international product life cycle. As analysed earlier, this model describes that, the invented products are first introduced in high-income countries, then shifted to upper-middle income countries and finally are shifted to low-income countries.

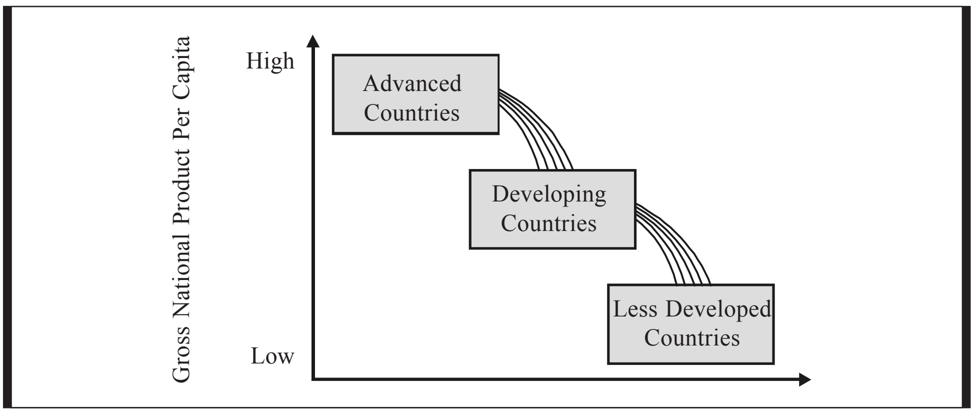

Fig 5.5 : International Product Life Cycle — Trickle Down or Waterfall Approach

Some of the USA firms shifted their manufacturing locations to low-cost locations or gave up market share to lower cost producers in third world countries. Consequently, these firms could not maintain their position as world class in quality and cost.

Selecting the strategy of shifting to low-cost locations does not seem to be effective. This is because, the company may gain in the cost reduction in the short-run, but it foregoes its competency in innovation, in research and development of product features, product manufacturability and quality due to low competition in developing countries.

Companies in the high-income countries are highly competitive. They are innovative, produce the products based on the changing taste and preferences of customers and create entry barriers for the competitors from low-income countries.

Therefore, the best strategy is to be in the high income countries, in order to be innovative, dynamic in meeting the changing needs of the customers and build the competencies to meet the challenges posed by the competitors and environment efficiently.

Shower Model

Ohmae Kenichi proposed an alternative model to 'Trickle-down Approach', *i.e.*, shower approach. Under this approach, the strategy is to simultaneously introduce the newly developed product in all kinds of global markets *viz.*, high-income countries, middle income countries and low income countries. *Figure 5.6* presents the international product life cycle — Shower Approach.

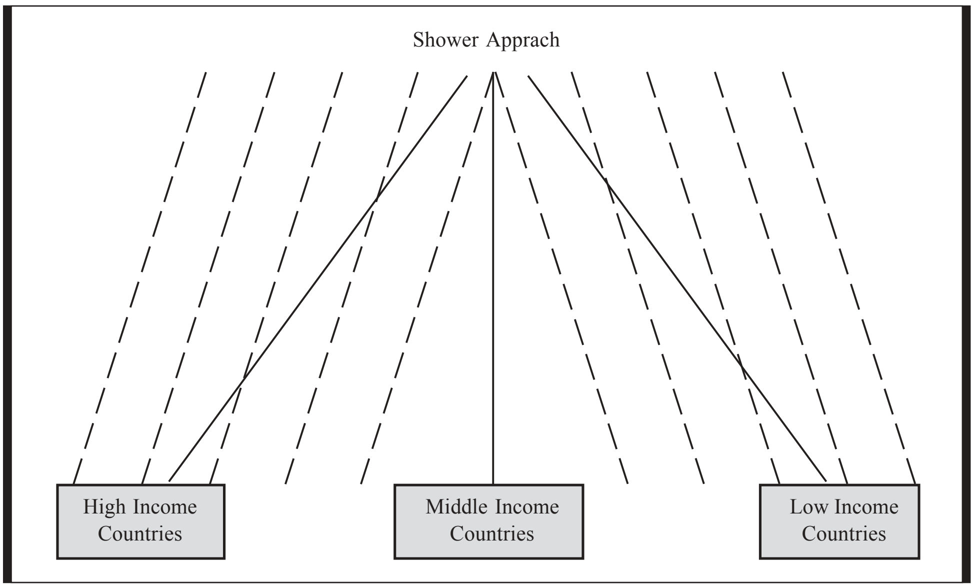

Fig 5.6 : International Product Life Cycle — Shower Approach

Trickle down to waterfall approach assumes that markets develop sequentially over the period. But, the post 1990s period gives the view that the entire world is like a global village. Market opportunities develop simultaneously around the globe. The shower approach recognises that the opportunities develop in all the countries at the same time.

Even under the shower approach, the entrepreneurs can take advantage of low-factor costs in lower-income countries. Therefore, the companies in advanced countries must be on the alert for competitive threats from low income and low factor cost countries. India being the low cost human resource country is a major production location for software programming.

3. BRANDING DECISIONS

We should understand what a trademark is, before proceeding.

A trademark in the USA according to the Lauham Trademark Act, 1947, "includes any word, name, symbol or device or any combination thereof adopted and used by manufacturer or merchant to identify his goods, and distinguish them from those manufactured or sold by others."

The outline of the branding decision is presented in *Fig. 5.7*.

Generic or No Brand: The first decision regarding branding is whether to brand or not. The trend towards non-branding products is increasing world-wide. In fact, the scales of non-branded products is increasing particularly in retail stores. The increase in demand for non-brand products is due to the availability of these products at less price. In addition, non-brand products are available in a number of sizes and models.

Branded Products: Most of the global companies go for branding. The customers of different countries find it easy to identify the branded products and they are aware of the ingredients and utility of the branded products. *For example,*, the customers throughout the world are aware of the products of Colgate-Palmolive, Pepsi or Coke etc. The global company can get better price and profits through branded products.

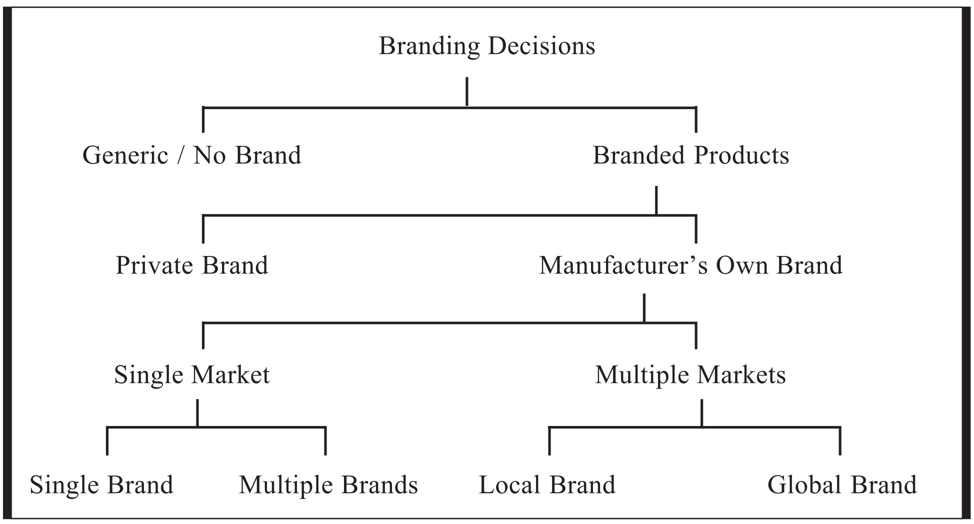

Fig 5.7 : Outline of the Branding Decisions

Source : Sak Onkvisit and John J. Shaw, *op. cit.*, p. 428.

Private Brand: Most of the exporting companies go for dealer's brand or private brand. The advantages of private branding include: easy in giving dealer's acceptance, possibility of getting larger market share, less promotional expenses, etc. Private branding is more appropriate for the small companies who export to various foreign countries.

Manufacturer's Brand: The manufacturer sells the products in his own brand. The advantages of manufacturer's brand include: better control of products and features, better price due to more price inelasticity, retention of brand loyalty and better bargaining power.

Single Brand: The global company go for a single brand for all its exports to the same country (or single market). The advantages of single brand in single market include: better impact on marketing, permitting more focussed marketing, brand receives full attention, reduction in cost of promotion etc.

Multiple Brands: The marketing conditions and the features of the customers vary widely from one region to the other, in the same country. Therefore, the exporter uses multiple branding decisions in such cases. Multiple branding enables the exporter to meet the needs of all segments. The other advantages of multiple branding include: creation of excitement among employees, gaining of more shelf space, avoidance of negative connotation of existing brand, etc.

Local Brands: Global companies have started widely using the local brands in order to give the impression of cultural compatibility of the local market. The advantages of local branding include: elimination of difficulty in pronunciation, elimination of negative connotations, avoidance of taxation on international brand, etc.

World Wide Brand/Global Brand: Exporters normally go for global brand. The advantages of global brand include: reduction of advertising costs, elimination of brand confusion, better marketing impact and focus, status for prestigious brands and for well-known designs, etc.

The advantages of different branding decisions are presented in *Exhibit 5.2*.

Strategies for Branding Decisions

- If the product has production consistency and salient attributes which can be differentiated, then it would be better for the manufacturer to go for branding otherwise better to sell the product without any brand.
- If the manufacturer is least dependent person, it would be feasible to go for the manufacturer's own brand otherwise, it would be feasible to go for a private brand.
- If there are intermarket differences like demographic and psychological, it would be feasible for having a local brand. Otherwise, it would be better to go for a global brand.
- If there are intermarket differences like demographic and psychological, it would be feasible for multibrands. Otherwise, it would be feasible to go for a single brand. (*See Box 5.3*)

EXHIBIT 5.2 ADVANTAGES OF EACH BRANDING ALTERNATIVE (From Manufacturer's Viewpoint)

No Brand
lower production cost
lower marketing cost
lower legal cost
more flexibility in quality and quantity control (*i.e.,* possibility of less rigidity in control)
good for commodities (undifferentiated items)

Private Brand
ease in giving dealers' acceptance
possibility of larger market share
no promotional hassles and expenses
good for small manufacturer with unknown brand and identity

Multiple Brands (in single market)
utilisation of market segmentation technique
creation of excitement among employees
creation of competitive spirits
avoidance of negative connotation of existing brand
gain of more retail shelf space
retention of customers who are not brand loyal
allowance of trading up or down without hurting existing brand

Local Brands
legal necessity (*e.g.,* name already used by someone else in local market)
elimination of difficulty in pronunciation
allowance for more meaningful names (i.e., more local identification)
elimination of negative connotations
avoidance of taxation on international brand
quick market penetration by acquiring local brand
allowance of variations of quantity and quality across markets

Brand
better identification
better awareness
better chance for product differentiation
better chance for repeat sales
possible premium pricing (*i.e.,* removal from price competition)
possibility of making demand more price inelastic

Manufacturer's Brand
better control of products and features
better price because of more price inelasticity
retention of brand loyalty
better bargaining power
assurance of not being bypassed by channel members

Single Brand (in single market)
better marketing impact
permitting more focused marketing
brand receiving full attention
reduction of advertising costs because of better economies of scale and lack of duplication
elimination of brand confusion among employees, dealers, and consumers
good for product with good reputation and quality (halo effect)

Worldwide Brand
better marketing impact and focus
reduction of advertising costs
elimination of brand confusion
good for culture-free product
good for prestigious brand
easy identification/recognition for international travelers
good for well-known designer

Source : Sak Onkvisit and John J. Shaw, *op. cit.*, p. 429.

BOX 5.3 MULTIBRAND MARKETING

Timex's more valuable asset may be its brand name. Its advertisements showing how rugged Timex watches have been well received over the years. As a matter of fact, the 1992 Gallup Watch Brand Survey found that Timex is number one in terms of name recognition, with 98 per cent of consumers knowing the Timex name. Seiko, with 87 per cent recognition, took second place. Timex's marketing error was its failure to keep up with market trends as the watch evolved from a functional object to a fashion accessory. According to the jewellers of America, the average consumer has five watches, drastically different from 1.5 watches from thirty years ago. Timex's Japanese rivals, Seiko and Citizen, have long adjusted by introducing a wide variety of styles and prices so that customers can have different watches for different looks. In the meantime, Timex was moving along as a one-brand company. The company has finally decided to go multibrand.

Source : "At Timex, They're positively Glowing", Business Week, 12 July 1993, P. 141.

4. PACKAGING DECISIONS

Packaging serves two functions, *viz.*, protecting product at minimum cost and promotion of the product.

- **Protecting the product:** If the product is exported to various foreign countries, extra protection is needed due to time, distance, varying environmental and climatic conditions, economic power of the people to buy large packages and the legal requirements of the country. People in Mexico can't afford to buy detergents in large packages, and hence, detergent manufacturers supply their product in plastic bags rather than in cardboard boxes or containers. Consumers in developing countries are more concerned with functional aspect of package than convenience.
- **Promotion:** Packaging is also used to promote the products. Avon used crystalline glass for packaging to meet the Japanese preference for beautiful packaging. Since the Japanese want a carton in packaging, BSR packs its products into two cartons.

Among the 4 'Ps' of marketing, the next important 'P' is price. Hence, we shall now discuss the pricing strategies.

(C) GLOBALISATION OF MARKETS AND BRANDS

However, the another trend is that globalisation of cultures. Globalisation of cultures have been reducing national differences and preferences. Consequently MNCs could market the same products and brands in many countries. For example, Coca-Cola, McDonald, Pepsi-Cola, Rock music, Hollywood movies, Revlon Cosmetics, Sony TVS, Levi's jeans and Johnson's baby products.

Market Segmentation

Market segmentation is adapting various marketing strategies for different patterns of purchasing behaviour of consumers. It is viewed that the consumer behaviour is based on the different consumer groups like sex, age, income level, race, education level, social class, religion, life style choices, personality and leadership styles.

Companies adapt different marketing strategies like product design, pricing strategies, promotion, distribution channels for different segments in order to minimise the sales in each segment. For example Toyota targets its Lexus model to high income segment and Corolla to lower income segment.

International business firms should consider two major factors viz., *(i)* market segmentation structure vary significantly from country to country. Therefore, international business firms should develop unique marketing mix strategies to appeal to the unique consumer behaviour of each market segment in each of the foreign market.

The study on "Emerging Markets: Are Chinese Consumers Coming of Age". Indicate, that Chinese in the age range of 40 to 55 has few parallels in other countries. "This group come of the age during China's violent and repulsive cultural revolution in the later 1960s and early 1970s. This segment of people in China tend to be highly sensitive price and respond negatively to new products and models of marketing." International business firms in China have to adapt unique marketing strategies to target this unique segment.

However, the same market segments exist across the world. *For example*, the buying behaviour of the youth towards music is almost the same throughout the globe. Similarly, we find the same segment of the youth towards coca-cola, beer, jeans and other consumer goods.

Product Attributes

A product is bundle of attributes that includes product ingredients, packing, technical attributes, quality, product functions, comfort, luxury etc. The attributes of a car include appearance, colour, performance, fuel consumption/efficiency, comfort, design, etc. Most of the international firms cannot produce the product with same attributes as the customers world wide prefer the products with varying attributes. This is due to varying cultures, level of economic development of the country.

Cultural Differences

International business firms should understand that, "there are no good or bad cultural behaviours and there is no cultural right or wrong. It is only just difference. People around the world feel as strongly about their culture, as we do about ours. Every country thinks its culture is the best." Therefore, international business firms should develop the product attributes based on the culture of the country.

As we discussed earlier in chapter as "International Business Environment", cultures vary from country to country and affect the marketing activities. *For example,* the sale of beef is dismal in India as beef is forbidden by Hindu law while the sale as hamburgers is dismal in Islamic countries as the consumption of harm in those countries is forbidden by Islamic law. In addition, the tradition influences the culture and culture in its turn influences the consumption behaviour. Tradition significantly influences food stuffs and beverages. *For example,* Indian consumers prefer vegetarian curries and water while the consumers in most of the western countries prefer boiled non vegetarian and wine or soft drinks. Similarly, culture influences the consumer behaviour with regard to most of the consumer products.

Economic Development

The level of economic development of a country determines the types and quality of products and services that are demanded. Consumers in advanced countries like the USA, the UK, Japan and Germany demand products with extra performance attributes, whilst consumers in less developed countries like India, China and Papua New Guinea normally demand base products, but not with extra attributes. Cars sold in advanced countries contain additional attributes like air-conditioning, power-steering, power windows, radios, CD players, while the cars sold in developing countries mostly do not contain these additional attributes.

Product and Technical Standards

Companies in various countries used to follow different technical standards like length, width, radius, models and thickness in addition to variations in moulds. *For example*, video equipment produced in the USA do not play video tapes produced in some of the European countries like the UK, France and the Germany. Similarly, video equipment produced in the UK, France and Germany do not play the video tapes manufactured in the USA. These variations in technical standards create hiccups to the globalisation process. However, some of the companies tend to bring uniformity in technical standards across the globe in view of globalisation of business.

Different Orientations in Product Development

Multinational companies should orient their product towards customers, and society in addition to production and sales.

Under production orientation, companies concentrate on efficiency of production and/or quality of production. Companies under sales orientation emphasise selling the products globally, whatever it could sell domestically. Thus the MNCs, under this approach, actively promote the sales globally. In contrast to production orientation, some companies orient themselves towards customers needs, preferences and requirements. However, MNCs, realised that strategic, marketing orientation combining production sales, and customers would be appropriate approach for overall development. Of late MNCs realise that successful and efficient global marketing requires serious considerations of environment, health, social and work related problems that arise when operating in global markets. Social considerations assume greater relevance in global markets as consumer associations, trade unions, political parties and environmentalists are becoming more globally aware and vocal.

(D) PRICING

There is no product without a price and there is no price without a product. Thus, price is an integral part of the product. Price may be high from the point of view of cost and low from demand point of view. Fair price reflects the perceived value of the product in question.

The study of international pricing includes:

1. Pricing Decisions
2. Pricing Policies
3. Factors Affecting International Pricing

4. Price Quotations
5. Dumping
6. Counter Trade.

1. Pricing Decisions

Though the pricing is significant among the 4 Ps, it receives the least attention in international marketing. Pricing decisions can be studied from the following approaches:

- Supply and Demand
- Cost
- Elasticity or, Cross Elasticity of Demand
- Exchange Rates
- Market Share
- Tariffs and Distribution Costs
- Culture
- Purchasing Power.

2. Pricing Policies

The pricing policies of international companies are:

- Standard price policy
- Two-tiered pricing
- Market pricing.

Standard price policy: Under the standard price policy, the international company sells the product at the same price for the customers of any country or nationality. Crude oil producers like Kuwait Oil, Aramco and Pemex sell their products to all customers at price determined by supply of and demand for crude oil in the world crude oil market.

Two-tiered pricing policy: International company under this policy sells its product at two prices, *viz.*, one price for domestic sales and another price for the foreign sales. This policy is adopted due to the involvement of shipping costs, tariffs and foreign distribution costs.

Marketing pricing policy: International companies following this policy customise their pricing on a market-by-market basis in order to maximise their profits in each market. Japanese automobiles follow this policy in pricing their cars.

Alternative pricing strategies: There are a number of alternative pricing strategies in addition to the above-mentioned strategies. These include:

- Discounts (cash, quantity, functional etc.)
- Financing or credit terms
- Bundle or unbundle.

3. Factors Affecting International Pricing

Pricing factors of international business vary from those of domestic business. A number of factors affect the international pricing. The important among them are:

(a) Cost: Cost is the prime factor that affects the pricing in international business. The costs include both manufacturing cost and marketing cost. The exporters may fix the price below the cost in a short run period and recover the losses incurred in the long-run. But in the long-run, they fix the price above the cost of production and cost of marketing.

(b) Competition: The global company fixes the price not only based on cost but also on the price of the comparable competitors. The exporter fixes the price in the short-run mostly based on the competitor's price in order to gain the market share.

(c) Product Differentiation: The product differentiation provides a wider choice to the customer, who in turn pay higher price for it. Global company uses the product differentiation in order to fix varying prices.

(d) Exchange Rate: The exchange rate provides opportunities in fixing the price for the products manufactured in developing countries and marketed in advanced countries. In other words, such products can be priced high due to the advantage of foreign exchange. The *vice versa* is true in case of products produced in advanced countries and marketed in developing countries.

(e) Economic Conditions of the Importing Country: Many global companies take the GDP, per capita income, disposed income, spending pattern, ability to spend and such other factors of the importing countries into consideration while fixing the price for the products to be marketed in that country. *For example,* Japanese automobile companies, South Korea's Kengan Civil Construction Company, Sony, and Aiwa take these factors into consideration in fixing the price.

(f) Government Factors: The Government of the exporting country and of the importing country also affect the pricing policies and practices. These factors are:

- Margin regulations (*profit rates*) formulated and implemented by the governments.
- Price floors (*lowest level of prices*) and price ceilings (*highest level of price*) determined by the governments.
- Subsidies provided by the governments in order to encourage the domestic industry or to protect the domestic customers.
- Tax concessions are provided by the governments in order to encourage exports.
- Other incentives like supply of finance, inputs etc., at lower prices in order to encourage domestic exports.

Elements of Export price structure

The normal ex-price structure is as follows:

(i) Cost of production

(ii) Producer's profit

(i) + (ii) = Ex-factory gate price

(iii) Packing and Marking

(iv) Loading charges at the factory

(v) Transportation charges to docks, railway station or airport

(vi) Handling charges and fee at port, railway station, airport

(vii) Cost of documents (like cost of bill of lading and airway bill)

(viii) Consular invoice, certificate of origin

(ix) Export duty (if any)

***(i)* to *(ix)* = C and F Price**

(x) Cost of insurance

(xi) Sea or air freight charges

***(i)* to *(xi)* = CIF Price**

(xii) Unloading charges at destination

(xiii) Import duties and taxes

(xiv) Fee paid to the Clearing Agent

***(i)* to *(xiv)* = Landed Price**

(xv) Transportation charges to Importer's Warehouse

(xvi) Importer's Margin/Mark-up

(xvii) Mark-up/Margin of all other market intermediaries in the importing country

***(i)* to *(xvii)* = Price to the consumer**

4. Price Quotations

Quotation describes several aspects of the product to be sold. The important among them are: product specification, price, delivery time, delivery location, time of shipment, payment terms, terms of sales etc. Sales terms in international business include variety of conditions. We shall now, discuss various price quotations:

- **Exworks (EXW) or Ex-Named Point of Origin:** In this, price is quoted from the point of origin of the product. There are variations in the origins like ex-factory, ex-warehouse, ex-mill, ex-mine, ex-plantation, etc. The seller, under this quotation, quotes the place, time of delivery. The buyer takes the delivery of the product at that origin and bears all expenses and risks from that point to the point of his place.

- **Free Alongside Ship (FAS) – Named Port of Shipment:** Under this, the seller quotes the price including delivery of goods alongside the vessel or any other mode of transportation. The buyer bears all the expenses and risks from that point. This includes port of export as a point of origin. The buyer's legal responsibility starts when the seller receives a clear wharfage receipt.
- **Free on Rail (FOR)/Free on Truck (FOT):** When the goods are to be sent by rail, the term free on rail (FOR) is used. *Similarly,* when the goods are to be sent by truck, the term free on truck (FOT) is used. The obligations of the exporter are fulfilled, when the goods are delivered to the carrier.
- **Freight or Carriage Paid (FCP):** The exporter is responsible for the carriage of goods to the agreed destination and has to pay freight up to the first carrier/agreed point. The FCP term is used when the goods are transported by road; rail or inland water.
- **Free on Board (FOB) — Named Point:** Under this, the seller quotes the point where price is applicable. There are a number of points like the named inland carrier at a particular inland point of departure, the moved inland carrier at the named point of exportation, the named port of shipment, the named inland point in the importing country. Under this, seller clears the goods for export.
- **Free Carrier-Named Point:** Under this mode, the exporter's responsibility is fulfilled when he delivers the goods into the custody of the carrier at the named point. This mode is used in case of multimodal transport. The seller's responsibilities include local delivery, loading, issuing bill of lading. The buyer bears all risks and expenses from the time the goods are placed on board.
- **Cost and Freight (C & F) – to Named Point of Destination:** Under this, the point of delivery is normally the port of importing country. The price, therefore, includes the cost of transportation to the named point of debarkation. The buyer pays insurance charges. The buyer bears the risk and cost when the goods pass the ship's rail.
- **Cost, Insurance and Freight (CIF) – to Named Point of Destination:** Under this, the point used for quotation is any location. But, the International Chamber of Commerce recommends that the point should be the destination. Thus, the price includes cost of products, insurance and transportation cost up to the point of destination (debarkation).
- **Ex-Ship (EXS):** Under this mode, the exporter makes the goods available to the importer on the ship, at the named port of destination at this cost.
- **Ex-Dock – Named Port of Importation:** Ex-dock means from the dock at the import point. Under this, the seller is responsible for placing goods in the dock of the named port in the importing country by paying appropriate duty by the seller.

- **Ex-Quay (EXQ):** The exporter is responsible, under this mode, to make the goods available to the importer into named Quay (after crossing the customs border at desired destination). Exporters pay for carriage, insurance and cost of unloading the goods from the ship.
- **Delivery Duty Paid (DDP):** Under this the seller pays all the duties and undertakes the delivery of goods to the named place in the importing country. The seller obtains import licence also, if necessary, arranges for customs clearance through a broker and arranges for the delivery of goods at the final destination named by the importer.

5. Dumping

We have studied dumping in chapter while discussing the activities of the World Trade Organisation. However, a brief discussion on dumping is necessary at this juncture. Dumping is a form of price discrimination. Under dumping the international company charges different prices for the same product in different markets. Dumping means selling the products at below the cost of production or at below the on going price in the market. Consequently, the imported goods are sold at prices so low as to be detrimental to local producers of the same kind of merchandise. *For example*, China dumped its steel, the USA and Malaysia dumped cooking oil in India. Consequently, Indian Government imposed anti-dumping measures to protect domestic industry.

Types of Dumping

- *Sporadic dumping:* Sporadic dumping occurs when an international company sells its unsold inventories in a foreign country to get rid of them.
- *Predatory dumping:* Predatory dumping is selling the product in a foreign market at a loss as a strategy of entering the market. Zenith uses this strategy for selling televisions and computers.
- *Persistent dumping:* Persistent dumping involves consistently selling the product at lower prices in one market than in other markets. Japan sells its electronic products at high prices in Japan and sells the same products consistently at lower prices in the USA and India.
- *Reverse dumping:* Under reverse dumping the product is sold at a high price in international markets and at a low price in the domestic market.

Anti-dumping Terms

Dumping adversely affects the domestic manufacturers, suppliers of raw materials, components, labour and other stakeholders of the domestic companies. Further, it affects the economic activity in the domestic country and also the government revenue. Hence, the domestic governments 'importing' impose anti-dumping terms/measures. *Box 5.4* presents the anti-dumping duties imposed by Pakistan.

Dumping is discussed in detail in the chapter on World Trade Organisation.

BOX 5.4 PAKISTAN IMPOSES ANTI-DUMPING DUTIES ON POLYESTER YARN

Pakistan has placed anti-dumping duties of up to 37 per cent on imports of polyester filament yarns. The duties will apply to over 30 companies heralding from four Asian countries: Malaysia, South Korea, Indonesia and Thailand.

- Pakistan's National Tariff Commission (NTC) has moved to prevent dumping of polyester fabrics in HS categories 5402 3300 (textured polyester yarn filaments) and 5402 4300 (single, untwisted polyester filament yarn).
- Provisional dumping duties, lasting for four months, range from 4 to 37 per cent on companies based in Malaysia, South Korea, Indonesia and Thailand.
- A final decision on anti-dumping duties will be made six months following the statement release.

The NTC decided on 12 November to uphold a complaint received by the Filament Yarn Manufacturers Association (FYMA) that polyester yarn was being "dumped" on the Pakistani market. The FYMA filed the complaint on 30 March and the NTC commenced investigations into 13 of the 38 identified companies exporting the yarn to Pakistan. In an official statement released on 12 November, it confirmed anti-dumping duties will be applicable to most of the companies investigated. The NTC looked into imports during the 12-months of 2004 to assess dumping, and a period of three-and-a-half years running until the end of 2004 to assess injury.

Another feature that affects pricing is counter-trade.

6. Counter-trade

Counter-trade is an arrangement to pay for import of goods and services with something other than cash. Thus, counter-trade is goods-for-goods deal. Reasons for counter-trade are:

- International debt and liquidity problems
- To provide access to the markets of developing countries
- To enable bilateral agreements between governments.

Types of Counter-trade

Types of counter-trade include: barter, counterpurchase, compensation trade, switch trading, offsets and clearing agreements.

- **Barter Counter-trade:** This type of countertrade involves simultaneous exchange of products/services of equal value. *For example*, Chinese coal was exchanged for the construction of a seaport by the Dutch in China.
- **Counterpurchase:** Counterpurchase involves two separate cash transactions which are equal in value. Money exchange takes place only in books of accounts. Thus, money does not need to change hands. *For example*, Brazil exports vehicles, steel and farm products to oil producing countries and buys oil in turn from them.

- **Compensation Trade:** Under compensation trade one country exports machinery, builds factories in another country with an agreement to import the goods produced in the factories built by them in the second country. A Japanese company sold sewing machines to China and received payment in the from of 300,000 pairs of pyjamas.

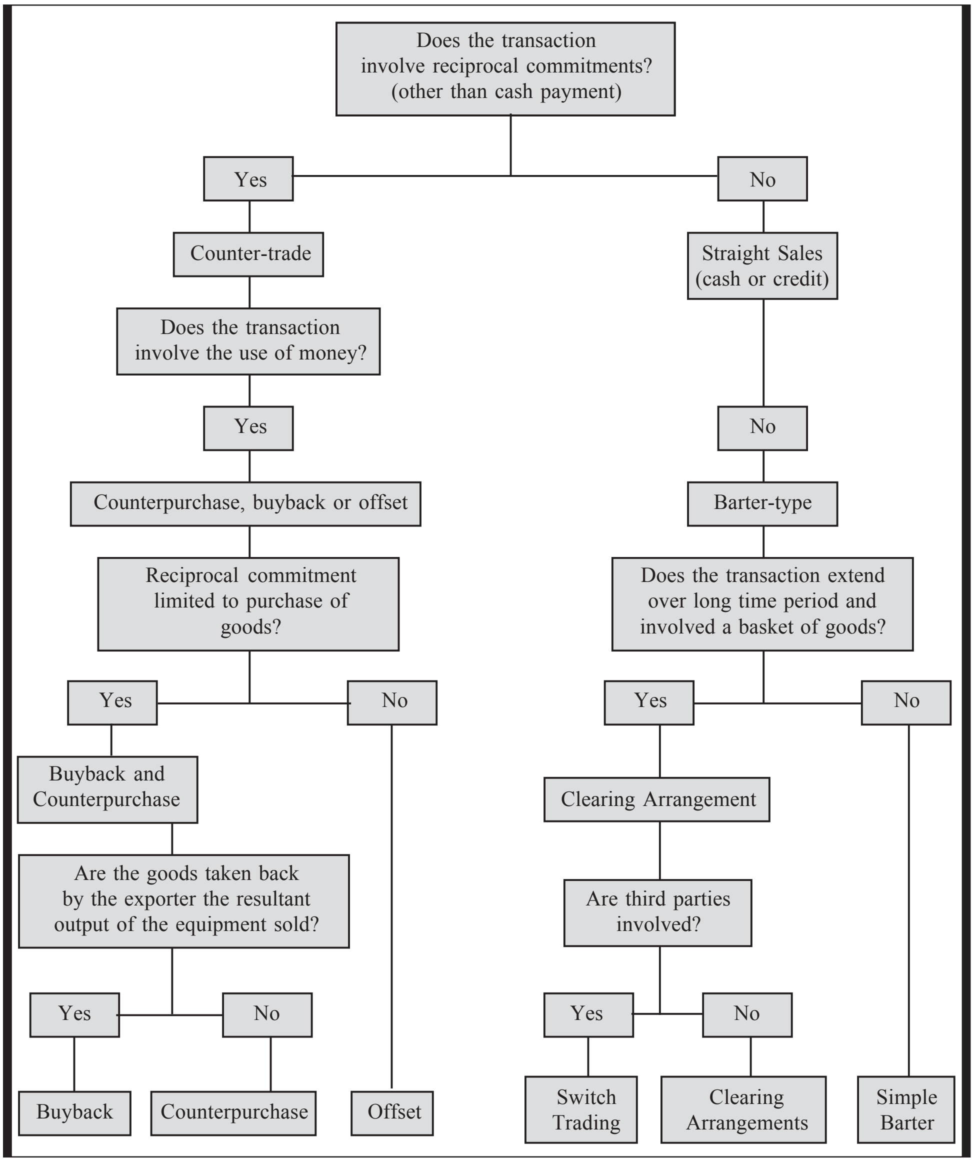

Fig 5.8 : Classification of Forms of Counter-trade

Source : Jean-Francoi Hennart, "Empirical Dimensions," p.245.

- **Switch Trading:** Switch trading involves a triangular trade agreement. When the goods are not wanted by one country, a third party enters the agreement by taking those goods and paying hard currency. *For example*, India exports software to the USA but needs oil. Therefore, the USA pays US dollars to the United Arab Emirates and enables India to import oil without any cash transaction between India and the UAE.

- **Offset:** Under the offset, the company is allowed to sell its products in a foreign country with a condition to purchase local products. The USA imported oil from the middle east and exported its defence products to those countries.
- **Clearing Agreement:** It is a barter with no currency transaction, but by maintaining clearing accounts in the central banks of the two countries.

Figure 5.8 provides classification of forms of countertrade.

Having discussed the first two 'Ps' of marketing, *i.e.*, product and price we now discuss another important 'P', *i.e.*, place or distribution channels.

(E) PLACE/DISTRIBUTION

International companies either sell directly or indirectly.

Indirect selling takes place through domestic agents/domestic merchants. This is a long channel involving a number of marketing intermediaries. *Figure 5.9 presents the international channel of distribution (market intermediaries).*

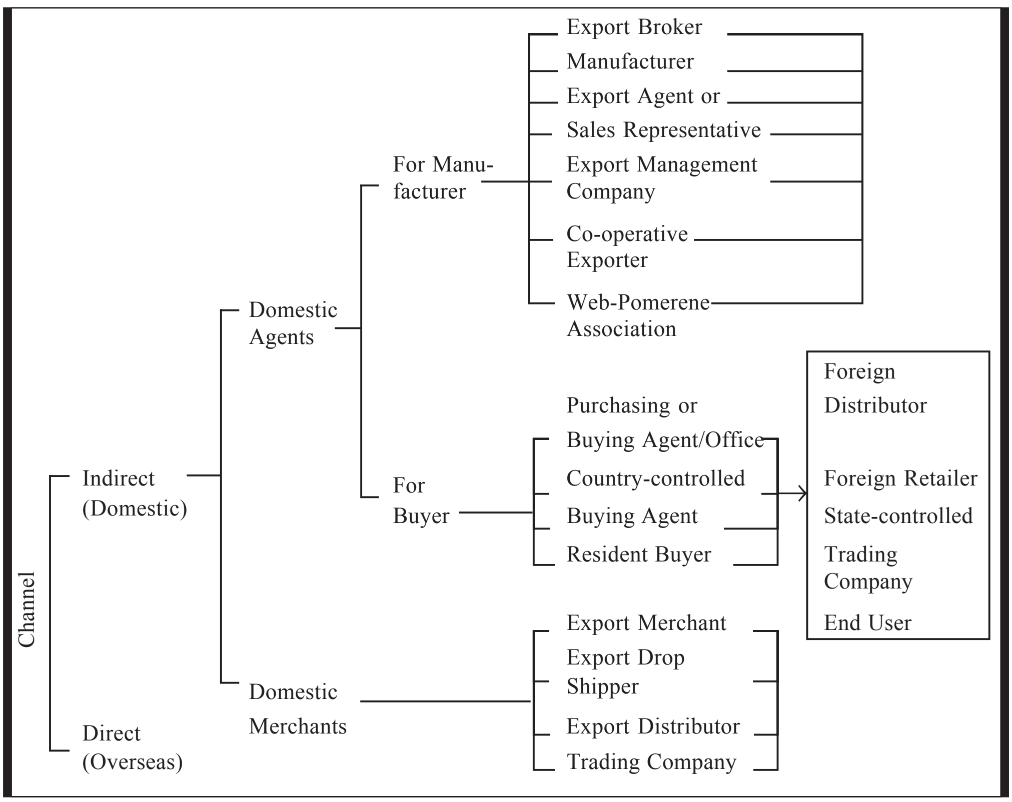

Fig. 5.9 : International Market Intermediaries

We study the place/distribution channels under: (1) Direct Selling (2) Indirect Selling.

1. Direct selling: Foreign company develops its own overseas marketing department or foreign marketing intermediaries and sells the product in the foreign market. *(See Box 5.5)*.

2. Indirect selling: Indirect selling is through market intermediaries.

BOX 5.5	DIRECT SELLING
	Dell Computer Corp. builds and markets a full line of desktop, notebook, and network-server PCs. After having found success in the United States, Dell Computer Corp. has gone overseas. The company operates wholly owned subsidiaries in fifteen countries which include most of the European Union countries, Mexico, Canada, and Poland. Its manufacturing plants are located in Ireland and Malaysia. Being committed to international markets, Dell has operations in 115 countries. Several skeptics questioned whether Dell's direct marketing strategy would work outside of the United States since Europe does not have the same telephone culture. Actually, consumers in most countries prefer to do business directly with a manufacturer rather than a third-party vendor. Dell's worldwide telephone sales force handles 35,000 calls each day. Dell's formula is to emphasise a solid product line, attractive prices, aggressive marketing, and quality services and support. In each country, the company advertises in the leading PC publications that are widely read by PC users and buyers. Not only has Dell been successful in building its business, but it has also legitimised the computer mail-order market. The company's subsidiaries are run by locals — not expatriates. Since countries differ in size, language, social structure, and business philosophy, the locals keep Dell abreast of the nuances of doing business in each market. How successful is Dell? It is world's largest direct marketer of IBM-compatible PCs.

Source : "How Dell Computer Found Success in Europe," DM News, 22 June 1992, pp.35, 44; and "How Dell Took the Direct Road," DM News, 27 March 1995, pp.23, 79.

Types of Market Intermediaries

- **Foreign Distributor:** It is a foreign company having exclusive rights to distribute the company's product in a foreign country.
- **Foreign Retailer:** It is a retailing company firm in a foreign country engaged by the distributor of the foreign country concerned to deal in and sell the products. *(See Box 5.6)*.
- **State-Controlled Trading Company:** It is a governmen*t company authorised to deal in and sell the products/services of foreign companies. For example*, the State Trading Corporation in India.

BOX 5.6 EXPORTING A SHOPPING EXPERIENCE

Pier 1 is a Texas based retailer, and its many stores can be readily found in the United States. Its retail formula is to import and stock unusual items, price them moderately, and display them in an integrated fashion to give an atmosphere of the United Nations. Blue Japanese sake cups, *for example,* are displayed with blue European plates rather than with other Japanese goods.

Pier 1 wants to repeat its retail magic overseas and plans to open 250 stores outside North America in seven years which will account for 5 per cent of the company's sales and 10 per cent of operating profits. This is not an easy task. Few American retailers have tried to do retailing abroad, and most foreign retailers that have opened stores in the United States have performed very poorly. *Naturally*, retailing is a local phenomenon.

The company believes that its formula is unique and can travel overseas. But some adaptation is required. Stores in Asia definitely have no need to carry chop sticks (which are popular in the U.S. stores) but will focus on American goods. Furniture will be made smaller for the Japanese market to suit tiny apartments. Also in Europe and Asia, Pier I will stock posters of American-pop heroes and other American-related items.

For most countries, Pier I will use joint ventures and licensing to penetrate the markets. In the case of Puerto Rico, the retailer feels that the market resembles Florida and that it knows enough about the market. Therefore, it does not need a partner in Puerto Rico where its thirty-five stores use the same inventory found elsewhere in the United States to attract Cuban and Hispanic Americans.

Source : Business Week, 31 May, p. 88.

- **Export Broker:** It is a domestic company engaged in arranging for export of goods of domestic companies by charging a fee.
- **Manufacturer's Export Agent/Sales Representatives:** It is a firm exclusively engaged to take up all export activities of a domestic manufacturer. This agent works for a commission.
- **Export Management Company:** This company manages the entire export activities of a domestic company on contract.
- **Co-operative Exporter:** Manufacturers of a particular product in the domestic country form into a co-operative union to manage their export activities. This co-operative union manages the export activities of its members. Examples include GE, Singer and Borg-Warner.
- **Web-Pomerence Association:** It is an association jointly formed by two or more domestic manufacturers to export their products. It is basically an export cartel.
- **Purchasing/Buying Agent:** It is an agency firm of a foreign buyer/importer. Foreign buying/importing company appoints agents to arrange for buying products from other countries.
- **Country-controlled Buying Agent:** It is a foreign government's agency or a quasi-governmental firm engaged in buying/importing products from other

countries. This firm buys products on behalf of the government of the importing country.

- **Resident Buyer:** It is an agency engaged in buying the products on behalf of the importer. This agent locates his firm near the manufacturers in the exporting country.
- **Export Merchant:** It is a firm engaged in buying the products in the domestic country in order to export to foreign countries on its own.
- **Export Drop Shipper**: Export drop shipper is also known as a *desk jobber* or *cable merchant.* He arranges a link between the exporter and importer. He informs the requirements of the customers in a foreign country to the exporter. Exporter, in his turn sends the products directly to the importer.
- **Export Distributor:** Export distributor is granted exclusive right to represent the manufacturer in selling the product in foreign countries. He operates either in his own name or manufacturer's name.
- **Trading Company:** Trading companies act as a link between exporting companies and importing companies. The trading companies in Japan are known as 'sogo shosha.' The largest trading companies in Japan include Mitsubishi and Mitsui.

The fourth P of international marketing mix is promotion. Now we shall discuss promotion.

(F) PROMOTION

Promotion plays a vital role in providing information of the product to the foreign customers. It also creates the desirability of the product among foreign potential buyers. Foreign companies desire to communicate with their marketing intermediaries and potential buyers to ensure favourable sentiment toward themselves and their products. Promotion is more culture bound than other Ps. Hence, the foreign companies must take special care in promoting the product in the host country. The promotion mix include:

1. Advertising
2. Personal Selling
3. Sales Promotion, and
4. Public Relations

1. Advertising

Though advertising is not given due importance in developing countries, it plays crucial role in international marketing and particularly for consumer goods and consumer durables. The international firm while formulating advertising strategy should consider —

- Message
- Medium
- Extent of global advertising efforts.

Message: The message of an advertisement refers to the facts or impressions, the company wants to convey to its potential customers. Coca Cola's advertising message stresses on "enjoyment." Products are used for different purposes in different countries. Advertising message should carry this separately in each country. *For example, motor cycles are mostly used for recreation in the USA and as a means of transportation in India. Honda and Kawasaki's advertisements stress the fun and excitement of riding in USA and reliability, functionalism and efficiency in oil consumption as a mode of inexpensive transportation in India and other developing countries.*

Country of origin of the product also plays vital role in message. *Japan is known for quality, the USA for trendy, France for fashion, Italy for stylish and India for low price goods.*

Medium: Medium is the communication channel to send the message to the prospective buyers. The marketer has to use the medium based on availability, legal restrictions, standard of living, literacy rates, culture of the country etc. In bilingual and multilingual countries like Belgium, Switzerland, Canada and India, the advertisers have to adjust their mix of media outlets.

The international companies have to go for different media where the rate of literacy is low and the economic power of the people is also low. In these countries most of the people do not have a television set. Colgate-Palmolive used video-vans and toured rural India and promoted company's oral hygiene products like toothpaste and toothbrushes.

Government imposes legal restrictions on using certain media for advertising certain products. Cigarette advertising on TV is banned in the USA, Malaysia, Hong Kong, China and South Korea. Consequently, the cigarette companies sponsored athletic events and purchased display ads at stadia which were picked up by TV cameras and media. *(See Box 5.7)*. McDowell plans to use net for advertising as government has banned liquor-promotion through TV.

***Global Versus Local Advertising*:** The foreign companies must also decide whether advertising message can be the same for the entire global market or different for each local market it serves. Coca-Cola, Bic pens, Levi jeans and McDonald Hamburgers have similar universal message. Some companies make adoptions to meet the country needs. Nestle used one in the USA but changed the background for various markets in promoting Kit-Kat — "Have a break, have a Kit-Kat." Some companies change their advertisement message based on the country needs. IBM used this regionalisation strategy in advertising its PCs. Unilever used standardised message to promote its products, but used regionalisation strategy to promote Lux Soaps in China due to the influence of culture on perception of soaps. Pepsi's global advertisement has a negative impact due to religious considerations. *(See Box 5.8)*.

BOX 5.7 BAN ON TOBACCO ADVERTISEMENT: A BAN IS NOT A BAN

Tobacco firms in Canada are prohibited from using traditional advertising outlets. Yet there is a loophole: they are permitted to sponsor sports and cultural events. As a result, they use sponsorships almost exclusively to promote their products. By capitalising on the exemption, they are able to keep their brand names and logos in magazines, newspapers, store windows, and on billboards. The advertisements about the sponsored events can be targeted to reach specific demographic segments. The advertisements promoting tennis and golf tournaments often resemble cigarette packages since they use similar graphic designs, typefaces, and colour schemes.

China is a tobacco company's paradise. There are some 3000 million smokers who consume 1.8 trillion cigarettes annually. Even though Beijing bans cigarette advertising on TV and radio and newspapers, magazines, and cinema, it excludes sponsorship of events and broadcasts from the ban. Philip Morris Cos., accounting for a quarter of all advertising spending in China, sponsors music programmes on national TV and radio, and China's national soccer leagues have become known as the Marlboro League.

Britain's B.A.T. Industries PLC has probably the best-known foreign brand in China (*i.e.*, 555). Like its competitors, the company is a sponsor. *For example*, it is the sponsor of the annual Hong Kong-to-Beijing Motor Rally. In addition, it uses the B.A.T. Education Foundation to give money to schools.

Cigarettes are a harmful product. If they were a brand new product recently created, one has to wonder whether they would ever be allowed to reach the market. One also has to question whether it is ethical for cigarette makers to continue marketing their products. In addition, a question must be raised as to why governments have chosen not to close all advertising loopholes.

Source : "Dodging Bans on Cigarette Ads in Canada," The Wall Street Journal, and "Ad Ban in China Makes Tobacco Tricky Business," The Wall Street Journal.

2. Personal Selling

The importance of personal selling varies from industrial products, to consumer durables and to consumer products. For industrial products, computers etc., personal selling is essential to provide technical information of the product. However, personal selling plays vital role in international marketing even for consumer goods as the firm and its products are new to the foreign markets. Avon and Amway used personal selling in European and Asian countries. American Internation group employed 5,000 sales people in Shanghai (China) to sell its life insurance policies. The companies appoint the natives as sales personnel for their personal selling as they are better aware of country's culture and build the relationship between the company and the customers. *(See Box 5.9)*.

3. Sales Promotion

Sales promotion includes specialised marketing efforts like coupons, in-store promotions, sampling, direct mail campaigns, co-operative advertising and trade fair attendance. International companies attend trade shows like Paris Air Show, Tokyo Auto Mart etc. British American Tobacco, Rothmans, Philip Morris and RJR/ Nabisco compete in Taiwan by handing out free cigarettes, in Korea by offering free cigarette lighters and desk diaries etc. Most of the Airlines companies use sales promotion to lure customers.

4. Public Relations

Public relations include efforts aimed at enhancing a firm's reputation and image with the general public. The consequence of public relations is that the firm is a 'good corporate citizen.' This image in its turn enhances company sales. US firms are particular to be a corporate philanthropic in order to build good corporate image in the minds of public. *Toshiba is a good corporate citizen. This image helped the firm from a problem of illegally selling advanced technology designed to make the detection of nuclear submarines harder to the former USSR.*

Similarly, the Tata Iron and Steel Company Ltd. (TISCO), India also earned the public image as a good corporate citizen. The image stopped the Government of India from nationalising TISCO's coal mines when they nationalised coal mines in the country in 1970.

(G) INTERNATIONAL MARKETING STRATEGIES IN DIFFERENT STAGES OF PRODUCT LIFE CYCLE

We discuss international marketing strategies under product policy, pricing policy, promotion policy and distribution policy.

Product Policy

Cost of production depends on various factors including cost of labour. The cost of labour is eight cents per minute in Japan, two cents in South Korea, and 0.5 cents in India.

Therefore, the strategies available are:

- Automation of the production process and introduction of robotics. IBM converted its Lexington (Kentucky) plant into one of the most automated plants in the world. Japanese automobile industry introduced robots in the assembly plants. Japanese VCR industry introduced automation to compete with South Korea with regard to cost of labour.
- Introduction of standardised products to reduce unnecessary operations and thereby reduce the cost of production per unit. Chrysler's Neon chooses to adopt an existing Chrysler three-speed as customers felt that four-speed automatic transmission was not anything special. By doing so, Chrysler's engineers saved $ 300 million.

- Locating some of the production process units in cheap labour countries: Ford Tractor is produced in Taiwan and Mexico. Some of the US stereo companies are located in Japan and South Korea.
- Out-sourcing for buying some of the components is another strategy to reduce the cost of production. Ford Festive outsourced from Kia Motors, Mitsubishi outsourced from Hyundai, G.M. Sprint from Suzuki and Pontiac Lemans from Daewoo.
- Contract manufacturing in different countries is another strategy. This is a modified version of outsourcing. IBM's PC components are produced in developing countries – monochrome monitor in South Korea, floppy disk drives in Singapore, and graphics, printer, keyboard, power supply and semiconductors in Japan. Final assembly and semi conductor production is undertaken in the USA.
- Firms should concentrate on producing sophisticated version once its product reaches maturity stage.
- Though Japan is the largest seller of VCRs, it cannot compete with Korean VCRs due to low labour cost in Korea. Therefore, Japanese manufacturers rely on new technology like 8mm camcorders.
- Production of an industry's standard product, in case of high-tech product.
- Sometimes, licensing or franchising is the best strategy in case of high-tech products and earn the profit as early as possible. Otherwise the competitors may grab the market.
- Sony tried to protect its Betamax video system. But Matsushita and Victor company took the world leadership position from Sony by liberally issuing licenses for selling their Video Home System to its competitors.

Pricing Policy

Companies, charge high price, in the first stage of the product and slowly reduce the price in the second or third stages of the product life cycle.

Japanese VCR producers cut their price by 25% anticipating the competition from the Korean producers and could retain their market and consumer acceptance. In contrast IBM reduced the price of its PCs very slowly with an assumption that it would be difficult to imitate their PCs. Most of the Asian companies imitated this PC and this strategy of IBM became a costly blunder.

- It is feasible to charge above the market price during the last stage of the product life cycle by maintaining top quality or sophisticated products.

Promotion Policy

- The companies during the initial stage of the product life cycle should go for high promotional activities. At this stage, the companies should also go for non-price competition.

- The companies may go for less promotional activities by starting high quality reputation activities during the second and third stages of product life cycle.

Distribution Policy

- The companies during the early stages of the product life cycle go for a strong dealer network.
- The distribution network should be expanded further when the product becomes more diffused.
- Komastu failed to compete Caterpillar in the USA due to the latter's loyal dealer network. In contrast GM's dealers started importing competitive brands of GM as GM limited its dealers from handling its brands.
- When it is difficult to keep the competitors away, invite the competitors to be the partners. GM entered partnership with Toyota, Suzuki and Isuzu. American Motors entered partnership with France's Renault, similar partnerships include Chrysler's with Mitsubishi, Ford with Mazda and Korean Motors.
- Concentration in a few segments is an appropriate strategy during the final stage of the product life cycle.

(H) INTERNATIONAL MARKET INTELLIGENCE

Introduction

International business firms analyse the business environment in order to assess the marketing opportunities in various foreign markets. They analyse not only environmental factors, but also marketing situations based on customer incomes, needs, competition products, price, promotion, consumer buying behaviour and the like. Marketing research play vital role in providing information to the business firms. Marketing researchers collect data and information from records, reports, customers, internet and the like. Internal records of the company provide data based on past results. International firms need not only data based on past results but also data based on current happenings. The data provided based on current happenings in various international markets is called 'international marketing intelligence'. International marketing intelligence system consists of two main aspects *viz., (i)* sources of data regarding everyday happenings in various relevant international markets and *(ii)* procedures of obtaining data by international marketing managers. Sources of data include newspapers, magazines, journals, trade publications, internet, customers, suppliers, distributors, salespersons, other company managers and the like. Procedure of obtaining data includes scanning newspapers, magazines, speaking, discussing and interviewing customers, distributors, suppliers, salespersons and other company managers. Data can also be obtained through questionnaires. International business firms should know what kind of data and information required regarding day-to-day happenings.

Information Required

International business firms require a large variety of data and information, *viz.,* markets, customers, market intermediaries like wholesalers and retailers, competition, foreign exchange, prescriptive information, resource information, and general conditions. Each of these items is discussed hereunder.

1. **Markets:** Day to day changes in demand due to competitors' products, promotional programmes. shift in government policies, changes in consumer incomes, change in technology and the like.
   - ***Consumer Behaviour:*** Shifts in consumer behaviour caused due to cultural variations, shifts in social institutions and other factors.
   - ***Products*:** Product features, product uses, development of new products, introduction of new products and changes to the existing products of competitors.
   - ***Marketing channels*:** Shifts in the preference over channels in the consumer preferences, shifts in channel preferences and use by the competitors, levels of satisfaction of the existing market intermediaries, etc.
   - ***Communication Media Availability*:** International marketing managers need the data and information about the availability and intensity of communication media. This information is useful to plan for promotional programmes. They also need information regarding the efficiency of media in reaching targeted consumers and its cost.
   - ***Market Responsiveness:*** Information is needed regarding the responsiveness of different parties in the market regarding the product, price, promotion and channels of the international business firms. Rate of market responsiveness of different parties enables international markets to make decisions more accurately.
2. **Customer Groups:** International business needs information regarding the customer groups based on age, sex, educational qualifications, occupations/ professions, income, ethnic groups, religious groups and beliefs, behaviour patterns, etc.
   - ***Repetitive Buyers***: International marketers also need information regarding the categories of repetitive buyers, frequency of buying, quantity of buying, purpose of buying, etc. and size and shift of customers. Information regarding the size of the customers, growth rate/decline rate and the causes there for in order to estimate the present and future market size and to decide up on the measures to be taken up to increase the market size by

attracting new customers and by retaining the existing customers and to increase the rate of usage of product and frequency of buying.

3. **Market Intermediaries:** Information regarding the market intermediaries are essential as they bridge the gap between the producers and the consumers.
   - ***Categories of Market Intermediaries:*** Information regarding different categories of market intermediaries like wholesalers, retailers, commission agents, brokers, etc. dealing in the same or similar products of the international business firms is needed as it enables the firm to select the right marketing channel.
   - ***Cost of Intermediaries:*** Information regarding the commission or mark-up will enable the international marketer to decide up on the selection of appropriate market intermediary.
   - ***Functions and Services that the Intermediary Provides:*** Information regarding the functions performed and services provided by various intermediaries to the customers as well as international firms enable to negotiate for better services as well as identifying the best intermediary.
   - ***Range of Products/Services*** **:** Information regarding the range of products/ services in which the intermediaries deal will help to know whether they are engaged in dealing with the competitor's products, substitute products and related or unrelated products. These factors help in selecting a right intermediary who can pay required attention on the firm's products.
4. **Competition:** Information regarding the current and possible future competition would enable the marketer to know the volume of the market available in a foreign country. Sometimes, companies enter foreign markets even when the existing firms cater to the total market demand. This information would enable the firm to design appropriate strategies to enter a foreign market.
   - ***Level and Intensity of Competition:*** The level of competition viz., corporate competition, business competition, product range competition and their intensities enable the firm to design appropriate competitive strategies.
5. **Foreign Exchange:** Foreign exchange has a vital bearing upon cost of business, price of the product to the customer and profits to the company. So this aspect of information is significant. Information relating to the balance of payments positions of foreign countries, interest rates, attractiveness of country currency in global market, acceptability for the country's currency in world market for settlement of accounts is necessary.
6. **Prescriptive Information**: Information relating to laws particularly business laws, regulations and rulings concerning taxes, dividends, in home and foreign countries, repatriation regulations in foreign countries, convertibility on current account and capital account is required to decide upon the financial benefits of entering a foreign market.

7. **Resource Information:** Information regarding availability of human resources, their skill level and behaviour patterns, material resources their quality, cost and terms and conditions of supply, availability, cost and conditions of offer of financial resources and information resources is needed to formulate international marketing strategies.
8. **General Business Environment:** Information regarding general business environmental factors like social, cultural, technical, economic, political and natural of the host country is necessary to decide upon the viability of the foreign markets. Sources of information can be broadly categorised into primary sources and secondary sources.

   Primary Sources: Primary sources are those sources from where original information is generated for specific needs. These sources include customers/ consumers, wholesalers, retailers and other market intermediaries, salespersons, managers and supervisors of the various firms including competitive firms, suppliers and the like. Specific and relevant information and data can be generated from these sources by collecting the opinions, attitudes, experiences and observations of the primary sources.

   Secondary Sources: Secondary sources are those sources where already collected and processed data and information for various purposes are available. Secondary sources can be classified into private sources and public sources.

   - ***Private Sources:*** Private sources include libraries of universities, institutes, resource organisations, Chamber of Commerce, Federation of Industry and Commerce, and various business organisations. In addition, the relevant internship report of MBA students, BBA students, B.Tech students and others are also used as a private source. Various research organisations do also collect information and supply for price. Internet is the quick and easy source of general information.
   - ***Public Sources*****:** Public sources of information are numerous. These sources include foreign governments and their websites, their embassies and consulates, trade promotion agencies, and international trade promotion organisations like World Trade Organization (www.wto.org), International Monetary Fund (www.imf.org), World Bank (www .worldbank.org), Asian Development Bank and International Finance Corporation. In addition, the Organisation for Economic Co-operation and Development (OECD)'s Publications, occasional papers and World Economic and Financial Surveys of International Monetary Fund, World Bank Publications and the publications of other international bodies are some of the best public sources.
   - ***Internet:*** In addition to the published data in the form of hard copies, various organisations make available the soft copies of general data and information in their websites. Some of these organisations provide specific data and information on payment of price also.

(I) INTERNATIONAL MARKETING INFORMATION SYSTEM

International marketing information system (IMIS) is an integrated and comprehensive network of information relating to all areas of international business having a direct or indirect bearing on marketing. The purpose of this system is to provide relevant and accurate information at the right time and place for decision-making and implementation to all managers concerned. International marketing information system (IMIS) helps managers to scan the relevant environment, identify opportunities and potential threats and formulate international marketing strategies and also other strategies. IMIS is an important sub-system of the broader management information system.

Automated System: Collection of data and information, processing and filing them have became easy and accurate with the computerisation and networking of offices. However, there are certain offices both in advanced countries as well as developing countries that still depend on manual processing of data and information. Marketing information system need not be computerised or automated. However, it is easy and also relatively less costly to computerize the marketing information system. In addition, the computerised and automated information system processes and provides the information and results accurately at less time.

System Design: System design is an important aspect of the international marketing information system. Various information requirements are gathered, and converted into one or more plans in the process of the system design. These plans clearly specify the procedures and programs in collecting, recording, tabulating and analysing international marketing data and information. Various alternative plans are prepared, compared against each other and the best plan will be selected and implemented. Finally, the selected system needs to be installed. The marketing manager should make sure that the installed system functions and produces results as planned.

The next step is to provide training to the system operators and system users. The system should be put under test for sometime and during that time the comments of the system operator and users should be evaluated and necessary changes may be brought in the system design accordingly in order to ensure smooth operation of the system in the long run.

The system should be continuously monitored and evaluated even in the long run and necessary modifications may be implemented continuously in order to enrich and update the system to serve the users more efficiently.

Characteristics of Sound International Marketing Information System: The international marketing information system should possess the following characteristics, to be effective and efficient.

- According to Sweeney and Boswell, the system should be user-oriented, expandable, comprehensive, flexible, integrated, efficient, cost effective, reliable, timely and controllable.
- IMIS should be systematic and self-perpetuating.
- IMIS should be continuously audited, evaluated, and updated.
- IMIS should be allowed to receive information from global marketing environment and update the system.
- The system should be time independent, as it should provide the services around the clock.
- The system should also incorporate other characteristics like standardization, uniformity, flexibility and integration.
- The system should be location independent as it should collect and incorporate information from all countries and markets and also allow the usage by all markets in all countries.
- The system should incorporate cultural knowledge and linguistic capability from all strategic points of the markets.
- Laws vary from country to country and in some countries from province to province. However, certain kinds of information should be standardised in order to ensure uniformity.
- The system should allow certain degree of flexibility.
- The system should integrate the data as it serves the diversified markets in several countries with time, cultural, political, and language variations.

IMIS – Sub-systems: IMIS consists of a number of sub-systems. Important among them include internal reporting, marketing research and marketing intelligence.

- ***Internal Reporting Sub-system:*** This sub-system incorporates the internal data and information on daily basis regarding sales, consumer feedback, sales orders, shipment, inventory levels, promotional programs and their efficiencies and cost, price, discounts, inventory levels, debtors and the like. This information is important, as different departments located in various countries need it on a continuous basis. The system can incorporate automatic updating of these data.

Marketing Research: Marketing research sub-system is vital for various and specific marketing activities. Marketing research sub-system incorporates various marketing research studies conducted by the company in particular and other companies and research organisations in general. This sub-system will be discussed in detail in later section of this chapter.

Marketing Intelligence Sub-system: This is an active and dynamic sub-system. This sub-system incorporates data and information regarding daily happenings. This sub-system collects the data from news papers, magazines, internet, salespersons, suppliers, marketing intermediaries, government agencies, research organisations and the like. This sub-system incorporation data relating to all aspects of international marketing environment, which affect the marketing activities in various countries directly and indirectly.

***Implementation of IMIS*:** The system should be implemented very carefully as the implementation process should be in conformity with the local laws of the country concerned. Data users in some countries need to be registered with the appropriate body. Similarly, personal privacy laws are strictly implemented in some countries. Therefore, the system should be careful in collecting personal data.

Value Addition: IMIS should not be mere a system of data collection, storage and providing data. The system should process the data and information and prepare the analytical reports. The analytical reports should incorporate the results of earlier studies, theoretical concepts, experiences and the like. The report should also provide results of the analysis, recommendations, suggestions and conclusions based on the data and analysis.

Marketing Research

According to the American Marketing Association marketing research involves the "systematic gathering, recording and analyzing of data about problems relating to the marketing of goods and services." This definition fails to deal with planning or designing of research problem. Kotler et.al., define marketing research as, "the systematic design, collection, analysis and reporting of data and findings relevant to a specific marketing situation facing the company."

Scope of Marketing Research: Scope of marketing research studies at international level include market measurement studies, competitive studies and studies of the international environment. Market measurement studies identify the current market size and potential size of various international markets and the firm's share over a given period of time. Competitive studies identify the impact of competitors' marketing strategies and practices on the firm's present sales and potential sales in various foreign markets. International environmental studies identify the impact of various environmental factors on the firm's current and future marketing activities in various countries.

The scope of marketing research at tactical level includes impact of marketing policies and strategies on product issues, price issues, promotional issues and channel issues.

Process of Marketing Research: Steps in the process of marketing research include:

- Definition of Research Problem
- Research Design and Sampling
- Methods of Data Collection

- Measurement and Data Analysis
- Presentation of Report.

Definition of Research Problem: Research Problem should be defined clearly and exhaustively. It should not be too narrow and too broad. Marketing manager, based on the preliminary information or data or signals of various marketing issues defines the research problem.

Research Design and Sampling: Research design is the detailed plan of investigation. It is the blue print of the detailed procedures of testing the hypothesis and analysing the data. There are different kinds of research designs. They include:

- **Case Study Method:** This method explores and analyses the life of a social or economic unit.
- **Market Survey Method:** It is a process by which quantitative facts are collected about the social and economic aspects of community composition or economic composition.
- **Experimental Method:** This method implies a controlled observation of a succession of events. Various experimental methods include:
  1. Model building method
  2. Input-Output Method
  3. Cost-Benefit Analysis Method.
- **Other Methods:** Other methods include field investigation research, evaluation research, action research, ex-post facto research and laboratory research.
  1. **Field Investigation Research:** It is a research study in realistic situation in which the experimenter under manipulates one or more independent variables as carefully controlled conditions as the situation will permit.
  2. **Evaluation Research:** This method can be concurrent evaluation, periodic evaluation and terminal evaluation study.
  3. **Action Research:** It is a research through launching of direct action with the objective of obtaining workable solutions to the given problems.
  4. **Ex-Post Facto Research:** It is a systematic empirical enquiry in which the scientist does not have direct control of independent variables, as inherently they do not possess manipulability character.
  5. **Laboratory Research:** Laboratory research exercise control over independent variables and isolate their influence.

Other types of study include one group study, static group comparison, and pretest or post-test control group, posttest-only control group. The researcher selects one of these methods depending upon the problem. The researcher cannot contact all the customers due to the similarities of customer characteristics and constraints of time and money. As such the researcher selects a sample of customers who represent the characteristics other customers. There are a number of sampling techniques. The major categories of sampling techniques are probability sampling techniques and non-probability sampling techniques.

Criteria for research design include:

1. Capability to answer research questions adequately
2. Control of variables
3. Generalisation.

Methods of Data Collection: Broad categories of data collection methods include observation method and administration of survey questionnaires.

Observation Method: This method is more objective as the research directly observes the situations, events and happenings and records the observations. This method yields objectivity, as there will not be the influence of interviewer or others. Observation method is more useful in those situations, when interviewees cannot explain the reason. *For example*, Toyota's Product teams could observe how close cars were parked to one other at Houston Country club and suggested to implement sliding doors when customers could not explain the need. Customers in some countries do not show their personal activities and their tastes and preferences. Observation method is more appropriate in such circumstances.

Administration of Questionnaires: Survey of questionnaires is widely used method due to speed and less cost. Telephonic interviews are more prominent in the USA, personal door-to-door methods are prominent in the UK, and Switzerland, central location and street interviews are more common in France and mail interviews and street interviews are prominent in the Netherlands and Sweden, personal interviews are more prominent in India, Malaysia, Indonesia and Papua New Guinea.

Measurement and Data Analysis: The researcher after collecting data has to tabulate it and use appropriate statistical tools to measure it. The researcher should take special care to ensure reliability and validity of measurement of data.

Industrial Growth pattern analysis provide insights into market demand as they reveal consumption pattern, and market opportunities. Trends in production indicate potential markets for companies. Income elasticity explains the relationship between demand for a good/service and change in income. Income elasticity studies of consumer goods show that necessities like food, and clothing are characterised by inelastic demand.Cluster analysis groups maximise within group similarities and between group differences. The researcher has to select appropriate technique of data analysis and present it.

Presentation of Report

The researcher after analyzing the data has to write the market research report and present it. The report should be prepared systematically with executive summary, introduction, conceptual analysis, data presentation, data anlaysis, findings, recommendations, conclusion and bibliography. The researcher has to present the report after he prepares the first drafts of the report. He has to revise the draft based on the comments of the marketing managers and other managers. The researcher may avoid usage of technical jargon and statistical tools in the report as many managers are uncomfortable with these. The researcher, then finalises and submit the final report. The recommendations and suggestions provided by the research should be praticable, but not highly theoretical and conceptual based. Marketing research report should encourage and enable the marketing managers to implement the recommendations for the benefit of the company.

POINTS TO BE REMEMBERED

- Various international environmental factors affect the marketing aspects of international business.
- Product strategies include: new product development, market segmentation, product positioning, product adaptation, product life cycle, marketing strategies, pricing policy, promotion policy, distribution policy and branding strategies.
- Pricing strategies include pricing policies, dumping and countertrade.
- Place/Distribution strategies include types of market intermediaries.
- Production strategies include advertising, personal selling, sales promotion and public relations.

KEY WORDS

- Marketing
- Marketing Mix
- Standardisation
- Customisation
- Product Adoption
- Pricing Policy
- Export Procedure
- Branding Decisions
- Anti-dumping
- Ethnocentric Approach
- Polycentric Approach
- Geocentric Approach
- Product Positioning
- Promotion Policy
- Distribution Policy
- Pricing Policy
- Dumping
- Resident Buyer

QUESTIONS FOR DISCUSSION

1. What are the differences between standardisation and customisation of products and services?
2. What is product development? Explain the product development.
3. What is international product life cycle? Explain the marketing strategies during different stages of Product Life Cycle.

4. What are the pricing strategies? Explain the different kinds of pricing decisions.
5. What is dumping? Explain the different types of dumping.
6. What is counter-trade? Explain the different kinds of counter-trade.
7. Explain the different types of market intermediaries.
8. What is promotion? Explain the different types of promotion strategies.
9. How does the global advertising differ from the local advertising?

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Unit Three

INTERNATIONAL HUMAN RESOURCE MANAGEMENT

CHAPTER OUTLINE

(A) GLOBAL RECRUITMENT
(B) GLOBAL SELECTION PROCESS
(C) EXPATRIATES
(D) PERFORMANCE APPRAISAL
(E) TRAINING AND DEVELOPMENT
(F) COMPENSATION AND BENEFITS
(G) WOMEN IN INTERNATIONAL BUSINESS
(H) DUAL CAREER GROUPS
(I) INTERNATIONAL INDUSTRIAL RELATIONS
(J) QUALITY CIRCLES
(K) PARTICIPATIVE MANAGEMENT

Introduction

Most of us have studied human resource management already. However, a bird's eye view of human resource management concept is presented.

The term human resources can be thought of as, "the total knowledge skills, creative abilities, talents and aptitudes of an organisation's workforce, as well as the values, attitudes and beliefs of the individuals involved."

Human Resource Management (HRM) is defined as managing (planning, organising, directing and controlling) the functions of employing, developing, compensating and maintaining human resources resulting in the creating and development of human relations with a view to contribute proportionately (due to them) to the organisational, individual and social goals.

Human Resource Management practices vary from country to country due to variations in culture, government policies, labour laws etc. Hence, the study of international HRM needs an altogether different approach. Now, we shall study the core functions of international HRM. (*Exhibit 6.1*)

EXHIBIT 6.1 CORE FUNCTIONS OF INTERNATIONAL HUMAN RESOURCE MANAGEMENT

(A) Recruitment	• Traditional Sources • Modern Techniques and Sources
(B) Selection Process	• Selection Procedure • Selection Approaches: Ethnocentric, Polycentric and Geocentric • Selection Techniques for global jobs
(C) Expatriates	• International Adjustment • Dimensions of international adjustment
(D) Performance Appraisal	• Objectives • 360^0 Appraisal • Methods • Performance Appraisal in global companies
(E) Training and Development	• Importance of Training and Development for Global Jobs • Need for Training and Development • Cross-cultural Training
(F) Compensation	• Importance • Objectives • Compensation in global companies • Profit sharing and ESOP
(G) Women in International Business	
(H) Dual Career Groups	
(I) International Industrial Relations	
(J) Quality Circles	
(K) Participative Management	

Source : Sak Onkvisit and John J. Shaw, *op. cit.*, p. 429.

(A) GLOBAL RECRUITMENT

Recruitment means the searching for prospective candidates and stimulating them to apply for jobs. Recruitment attracts a large number of qualified applicants who desire to work in the company. The recruitment information given by the global companies helps the qualified candidates who are willing to work to send their resume, alongwith a letter expressing their desire to work. It also helps the unqualified candidates to self select themselves out of the job candidacy. Thus, the accurate information provided by the global company attracts the qualified and repels the unqualified candidates.

Thus, recruitment helps the global company in finding out potential candidates for actual or anticipated vacancies in the company.

Sources of Global Recruitment

Sources of global recruitment include : Parent country nationals, Host country nationals and Third country nationals.

(i) Parent Country Nationals

Parent country nationals are employees (of a company or its subsidiaries located in various countries) who are the citizens of the country where the company's headquarters are located. Parent country nationals in international business normally are managers, heads of subsidiary companies, technicians, trouble-shooters and experts. They visit subsidiary companies and operations–

- to help them in carrying-out their operations
- to make sure that they run smoothly
- to provide advice and control them.

However, sending parent country nationals involves cost and causes ego and cultural problems. Hence, the North American companies stopped sending the parent country nationals to subsidiary companies operating in other countries.

(ii) Host Country Nationals

Host country nationals are the employees of the company's subsidiary who are the citizens of the country where the subsidiary is located.

Employing host country nationals is advantageous as:

- they are familiar with native culture.
- they are familiar with local business norms and practices.
- they manage and motivate the local workers efficiently.
- they are familiar with local bureaucrats, market intermediaries and suppliers of inputs.
- familiar with the taste and preference of the local customers.

However, there are certain disadvantages associated with the host country nationals. These include:

- They are not familiar with the objectives, goals and strategies of the parent company.
- They are unaware of the needs of the headquarters.
- They view the company only from the local perspective rather then from the global perspective.
- It would be difficult to train the host country nationals due to variations in the views about achievement, equity, the work ethic and productivity of the host country nationals from those of the parent country nationals.

(iii) Third Country Nationals

For example, Mr. Akhil – an Indian citizen – is working for an American subsidiary in France. Mr. Akhil is called third country national. Third country national is an employee of a company's subsidiary located in a county, which is not his home country. The software professionals of India who work in American subsidiaries located in various countries of Europe are called third country nationals.

The advantages of employing third country nationals include:

- Less cost with required expertise, skill knowledge and foreign language skills.
- Less risk of employing an Indian third national who speaks English fluently.
- They have a cultural fit due to their work experience in multicultural environment.

However, the local government may impose conditions and regulate in employing third country nationals.

(B) GLOBAL SELECTION PROCESS

Global business firms need people with higher order skills, balanced emotions, ability to adjust to multi-cultural recruitment, etc. Hence, the selection process of global companies varies from that of a domestic company. Now, we study the selection process of a global firm. Selection process includes selection procedure, selection approach and selection methods.

1. Global Selection Approach

Selection policy is vital in global business as it deals with the various types of people, jobs and placement. In fact, selection policy contributes for the achievement of the strategic goal of global business *i.e., 'thinking globally and acting locally'*. There are three types of approaches followed in selection policies in global business *viz.*, the ethnocentric approach, the polycentric approach and the geocentric approach.

- **The Ethnocentric Approach:** Under this approach, parent country nationals are selected for all the key management jobs. This approach was widely followed by Procter and Gamble, Philips, Matsushita, Toyota etc. When Philips filled the important vacancies by Dutch nationals, non-Dutch employees referred them to as *Dutch Mafia*. Some of the international firms follow this approach due to the following reasons:
  - Non-availability of qualified personnel in host countries particularly developing countries.
  - To maintain a unified corporate culture. Japanese firms mainly follow this reason. P&G also preferred this reason.
  - To transfer the core competencies of the company when the core competencies are held by the existing employees of parent country nationals.

Though this approach claims the above discussed advantages, it suffers from the following disadvantages:

- When important positions of the subsidiaries are filled with the parent country nationals, the staff of the host country feel frustrated resulting in low productivity.
- The subsidiary may fail to understand and respond to the host country's culture due to *'cultural myopia'*. P&G experienced a number of failures due to this problem and subsequently started filling, senior management positions by the host country nationals *(referred to as polycentric approach)*.

- **The Polycentric Approach:** Under this approach, the positions including the s4enior management positions of the subsidiaries are filled by the host country nationals. The reasons for adopting this approach include:
  - Host country nationals are familiar with the culture of the country including business culture.
  - Level of job satisfaction of the employees of the subsidiaries can be enhanced.
  - It is less expensive as the salary level of host country nationals is lower than that of host country nationals in case of MNCs of advanced countries.
  - It reduces overall cost of staff of subsidiaries.

Though this approach is a welcoming factor from the point of view of host country, it suffers from the following limitations:

- This approach limits the mobility of employees among subsidiaries and between subsidiaries and the headquarters.
- Organisational culture of the parent company cannot be completely adopted in the subsidiaries.
- Culture of the subsidiaries and the headquarters cannot be exchanged as it isolates the headquarters from their subsidiaries.

These limitations forced some organisations to employ the best candidates from any part of the globe *(referred to as geocentric approach).*

- **Geocentric Approach:** Under this approach, the most appropriate candidates are selected for jobs from any part of the globe. Global firms follow this approach due to the following reasons:
  - To have the most appropriate human resources.
  - To develop the people with multiculture and meet the challenges of cultural diversity.
  - To build multi skilling as a core competency and transfer it to all the subsidiaries.
  - To avert the problems of cultural myopia and enhance local responsiveness of the host country.

Though this approach seems to be superior to the other two approaches, it also suffers from the following limitations:

- Most of the countries insist that MNCs should employ their citizens. MNCs are allowed to employ foreign nationals only in the rarest cases.
- Implementation of this policy takes time as the MNC has to train and develop the people in multicultures.
- Implementation of this policy is also expensive.

Business Implications: MNCs with very limited geographic scope in culturally related countries can adopt the ethnocentric approach, whereas MNCs with wide geographic scope in culturally unrelated countries may adopt polycentric approach. However, the transnational companies whose geographic scope is very wide may adopt geocentric approach. Geocentric approach is appropriate for Coca-Cola, P&G and the like. Companies should take utmost care in selecting the candidates for overseas jobs. This is because the candidate should be competent in job knowledge, skills and competency in addition to having the skill of adaptability to the new culture and environment. Further, the employee's adaptability is not enough, what is equally important is the adaptability of the employee's spouse and family members to the new environment. *(See Box 6.1)*.

BOX 6.1 CULTURAL NON-ADAPTING OF EMPLOYEE'S FAMILY MEMBERS

Mr. Ramana Kote was working in TELCO as Human Resource Manager in Pune. He has been selected by Coca Cola as its regional manager in 1998 and later shifted him to its corporate office in New Delhi. Mr. Ramana and his family members are very happy for his quick promotions in Coca-Cola. Mrs. Sarala Devi is Mr. Ramana's wife. She strongly believes in Indian culture and the single career group. As such, she is housewife and takes care of children and her husband.

Mr. Ramana Kote has been innovative in formulating the number of performance appraisal programmes, cross-cultural training and compensation packages. He is also strong in conceptual knowledge. The corporate management of the company is impressed with his skills and abilities and transferred him to its headquarters in the USA.

Mr. Kote, his wife and two female children felt very happy regarding the US job. Mr. Kote and his family members landed in USA in March 2000. The company provided housing, medical and conveyance facilities to Mr. Kote and his family for three months *i.e.*, up to July 2000.

Mr. Kote likes his new job as it is highly challenging and rewarding. In addition, he has been interacting with the employees of different countries and the top executives. The family members were excited with the facilities, culture and the people initially.

Mr. Kote has been busy with his work at the office and could not spend time with the family members as he was spending time with them in New Delhi and Pune. Consequently, Mrs. Sarala was forced to spend most of her time in isolation as no one in the USA spends their time for others as it happens in India. She could not adjust with this cultural aspect of the USA at her late 40s. She forced her husband to leave the job and the country.

The outcome of the research studies indicate that for global jobs one must possess:

- A variety of individual, interpersonal and organisational skills.
- Job performance track record.
- Multi-cultural exposure and cultural fit.
- Relational abilities.

2. Selection Techniques for Global Jobs

Global companies require the human resources adaptable not only to the job and organisational requirements, but also to the emotions of the people of different countries of the world. As such, the selection techniques for global jobs vary from that of domestic jobs. Now, we shall discuss the selection techniques for global jobs.

- Screening the applicant's *background.*
- Conducting tests to determine the candidate's suitability to the *job norms.*
- Conducting tests to evaluate the candidate's suitability and adaptability to the *new culture and environment.*
- Conducting tests to evaluate the suitability and adaptability of *"candidates, spouse and family members"* to the new culture and environment.
- *Predicting the adjustment* of the candidate, his spouse and family members to the new job, culture of the company, country and the new environment.

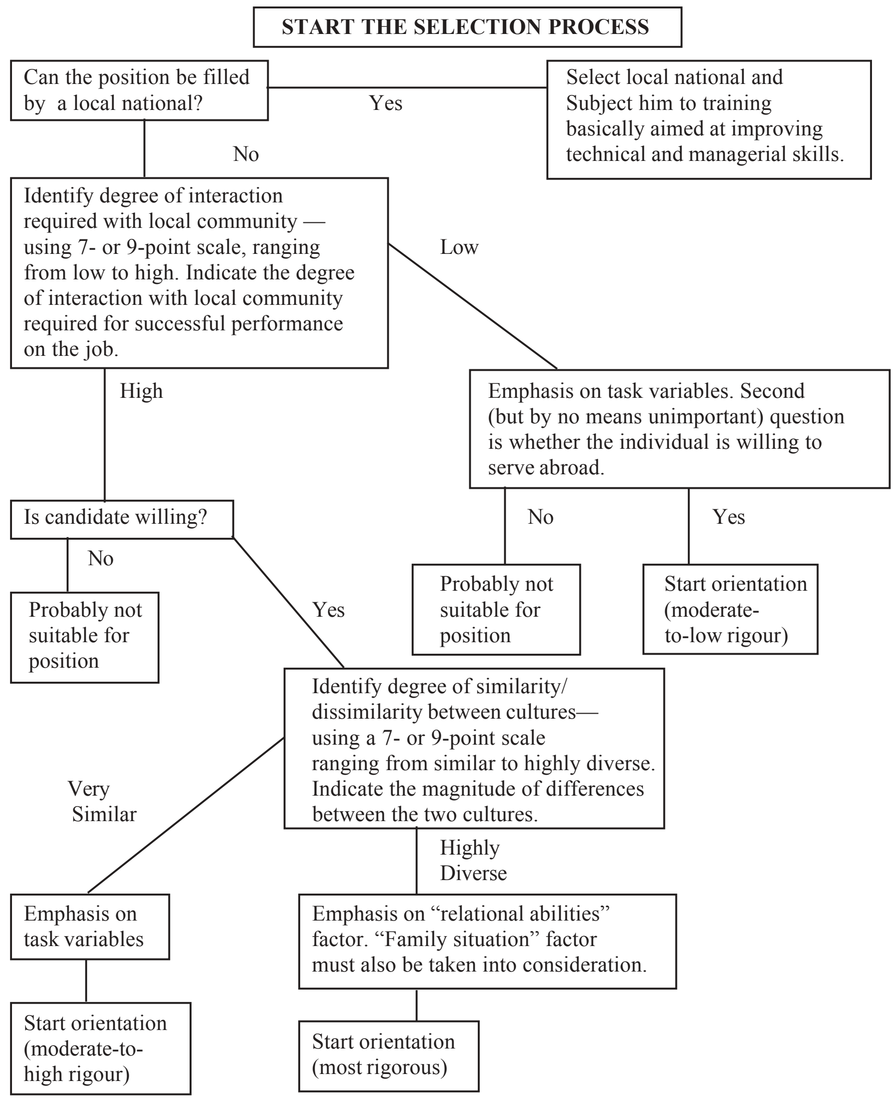
Rosalie Tung proposed a selection method for selection of expatriates. *Exhibit 6.2* presents the flow chart of the International Selection-Decision Process. The candidate should be asked questions relating to:

- His adjustment
- Interaction with the host nationals
- Technical competence
- Cultural novelty
- Family situation
- Communication skills.

The company has to measure the candidate on various variables regarding adjustment. The variables to be measured include:

- **The Individual Dimension:** The variables used to measure the candidate's suitability in this area include:
  - Candidate's self-efficiency
  - Relational skills of the candidate
  - Perceptional skills of the candidate
  - Job skills
  - Stress-reduction skills

EXHIBIT 6.2 FLOW CHART OF THE INTERNATIONAL SELECTION-DECISION PROCESS



"Emphasis" does not mean ignoring the other factors. It only means that it should be the dominant factor.

Source : R.L. Tung, 1981, "Selection and Training of Personnel for Overseas Assignments", *Columbia Journal of World Business, Vol. 16, No. 1, pp. 68-78.*

- **The Non-work Dimension:** The variables to be measured in this dimension include:
  - Cultural novelty
  - Host country's religions, social, cultural, sociological, historical, political and economic system – adjustment of the candidate, his spouse and family members to this new environment.

- **The Job Dimension:** The variables in this dimension include:
  - Job duties, responsibilities, tasks, etc.
  - Technical competency.
  - Human relations skills at the work place.
- **Organisational Cultural Dimension:** The variables in this dimension include:
  - Culture of candidate's previous organisation in his home country.
  - Candidate's background of working in different organisations with different cultures.
  - Candidate's ability to adapt to the new organisations, work places, group norms, and expectations.

Exhibit 6.3 presents the employee selection matrix for international jobs.

EXHIBIT 6.3 INTERNATIONAL SELECTION MATRIX

Biographical	*Standardized Data*	*Work Tests*	*Assessment Samples*	*Inter-Centers*	*Views*	*References*
Expatriate						
Strategic Factors						
• Co-odination and Control	✓				✓	✓
• Information and Technology Exchange	✓				✓	✓
• Executive Development	✓	✓	✓	✓	✓	✓
Assignment Required Professional Skills	✓	✓	✓	✓	✓	✓
General Managerial Skills						
• Conflict Resolution Approach		✓	✓	✓	✓	
• Leadership Style		✓	✓	✓	✓	
Communication Skills						
• Foreign Language Skills	✓	✓				
• Willingness to Communicate		✓	✓	✓	✓	
• Relationship Development		✓		✓	✓	✓
Individual Characteristics						
• Ethnocentricity		✓		✓		
• Cultural Adaptability		✓		✓	✓	
• Stress Reduction Skills		✓		✓	✓	
Spouse Career Considerations					✓	
Children's Educational Needs					✓	

Source : Black, J. S., H.B. Gregersen, & M. Mendenhall, 1992, Global Assignments: Successfully Expatriating and Repatriating International Managers. *CA.: Jossey-Bass, Inc.*

(C) EXPATRIATES

Global companies, after selecting the candidates place them on the jobs in various countries, including the home country of the employee. But, the employees of the global companies are also placed in foreign countries. Even those employees who are placed initially in their home countries are sometimes transferred to various foreign countries. Thus, the employees of global companies mostly work and live in foreign countries and their family members also live in foreign countries. Employees and their family members working and/or living in foreign countries, are called expatriates in the foreign country.

Expatriates are those living or working in a foreign country. The parent country nationals working in foreign subsidiary and third country nationals are expatriates. Large number of expatriates normally have adjustment problems with the working culture of the company, country's culture, laws of the country etc. Some expatriates adjust themselves easily, while some others face severe problems of adjustments. Such employees about their assignments and return to home country by terminating their work contracts. Many Indian expatriate employees in Maldives could not adjust to the culture and returned to India before their assignments were completed. Thus, the major problem with expatriates is adjustment in the new international environment.

1. International Adjustment

The international adjustment is the degree to which the expatriate feels comfortable living and working in the host culture. This significantly influences job performance. The expatriate is completely new to the host country environments, social rules, norms etc. The expatriates have a strong desire to reduce psychological uncertainty in the new environment. Psychological uncertainty is also called *cultural shock.*

Nancy Adler defines *cultural shock* as, "the frustration and confusion that result from being bombarded by uninterpretable cues." *For example*, students in the USA drink beverages in the class-room, students in African countries leave the class immediately after the close of the lecture but before the teacher leaves the class, people in the USA wish you immediately when there is eye-to-eye contact with you. These cultural differences cause *cultural shock* to Indians.

Researchers found that to a large degree culture shock follows the general pattern of a U-shaped curve as presented in *Fig. 6.1*. This figure presents the relationship between culture shock and the length of time the expatriate has been working in the host country's culture. The 'U' is divided into four stages, *viz.*, honeymoon, culture shock, adjustment and mastery.

- **Honeymoon stage:** The expatriate and his family members are fascinated by the culture of the host country, the accommodation, the transportation facilities, educational facilities to the children etc., during the early stage of arrival. This stage lasts upto 2-3 months period.

- **Culture shock stage:** The company takes care of the new arrivals and completely neglects the previously arrived employee and his family after three months. During this stage, the employee has to take care of himself and his family members. Expatriate gets frustrated, confused and unhappy with living and working abroad. His social relations are disillusioned during this stage. He gets the shock of the existing culture.
- **Adjustment stage:** The expatriate slowly learns the values, norms, behaviour, of the people, their culture etc. He slowly adjusts himself to the culture of the foreign country.
- **Mastery stage:** The expatriate after adjusting himself with the culture of the foreign country, can concentrate on working efficiently. He learns and adopts to the new environment completely and becomes like a citizen. He behaves and functions like a citizen at this stage.

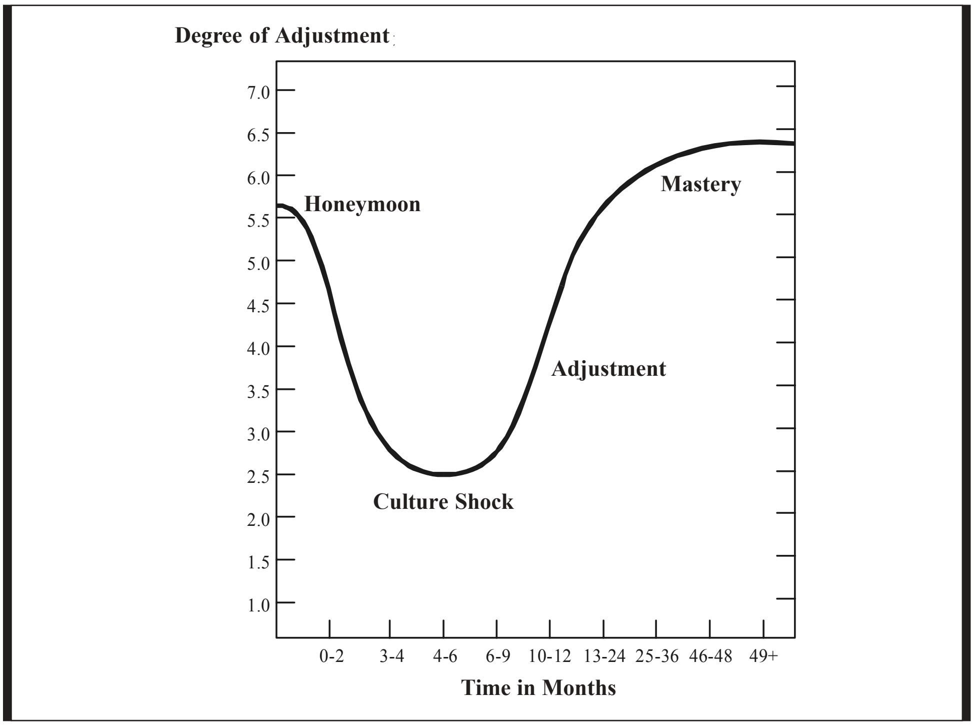


Fig. 6.1 : The U-Curve of Cross-Cultural Adjustment

Source : Black, J.S. & M. Mendenhall, 1991*, "The U-Curve Adjustment Hypothesis Revisited: A Review and Theoretical Framework",* Journal of International Business Studies, Vol. 22, second quarter, pp. 225-247.

2. Dimensions of International Adjustment

International adjustment has three dimensions, *viz.*, adjustment to the overseas workplace, adjustment to interacting with the host nationals and adjustment to the general environment. The research studies discovered certain skills which would help both the individual expatriate and international organisations in dealing with the adjustments. *Figure 6.2 presents a framework of international adjustment. There are four dimensions of adjustment, viz., individual, job, organisation culture, and non-work.*

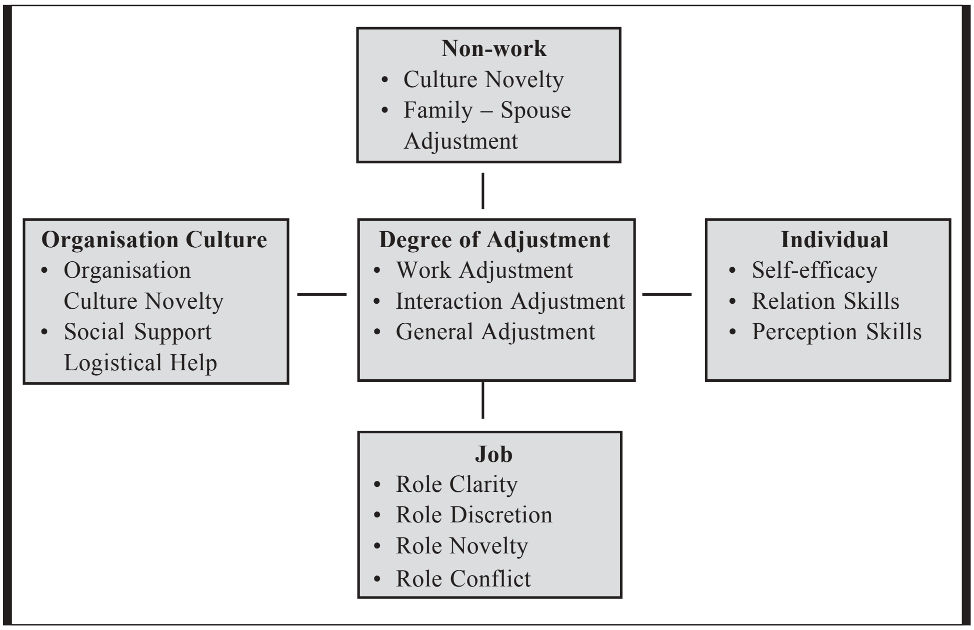


Fig. 6.2 : Framework of International Adjustment

Source : Adapted from: Black, J.S., M. Mendenhall, & G. Oddou, 1991. *"Toward a Comprehensive Model of International Adjustment: An Integration of Multiple Theoretical Perspectives,"* Academy of Management Review, 16 (2), pp. 291-317.

Individual Dimension

Individual dimension includes the skills and the capabilities that the expatriate possess. These skills include cross-cultural skills. There are three sets of individual skills, *viz.*, self efficacy, relational and perception skills. Now, we discuss these three types of skills.

Self-Efficacy Skills

The expatriate should have self-confidence, self-esteem and mental hygiene. He should be able to keep mental and social health with a feeling of being able to control or deal with surprises from the host cultural environment. Areas of self-efficacy are: stress reduction, technical competence and reinforcement substitution.

- ***Stress Reduction:*** Stress reduction abilities include abilities to deal with interpersonal conflict, financial difficulties, variations in business systems, social alienation, pressure to conform, loneliness, differences in housing, climate etc. These factors affect the expatriate job performance. Expatriates should have an on-going clear strategy to reduce the stress.

- ***Technical Competence:*** Technical competence of the employee is an important factor that determines the degree of employee adjustment in the foreign country.
- ***Reinforcement Substitution:*** This skill involves "replacing activities that bring pleasure and happiness in the home culture with similar — yet different — activities that exist in the host culture." The common interests would be sports, music, art, dance, and social groups.

Relational Skills

Relational skills include expatriate's ability, desire and tendency to interact, mix or involve and develop relationships with host nationals. The skills in this regard include:

- ***Finding Mentors:*** The expatriates find the host nationals, who have similar interests and can guide them. My own personal experience, while I was working in Eritrea, I found common interests in Dr. Tesfa-Yesus Mehary and in myself. I also found guiding and mentoring skills in Dr. Tesfa-Yesus Mehary and I accepted him as my mentor. He helped me in building relations with other Eritreans and adjust to Eritrea with least problems.
- ***Willingness to Communicate:*** Fluency in the host country's language is not a pre-condition for building relations with the foreign nationals. What is more important is making efforts to learn the language as a means for familiarising with the foreign nationals and their culture. Strategically using the proverbs, popular songs, famous incidents from the history, jokes, information about religion, sports of the host country is called, *"Conversational Currency."* Using these titbits fastens the process of building the relations with the foreigners.

Perception Skills

These skills include expatriate's ability to understand the behaviour of the host nationals, their practices, culture etc. These skills reduce the degree of psychological uncertainties associated with cross-cultural experiences. The expatriate should not view the host nationals as backward, or stupid or unsophisticated.

Non-work Dimension

The non-work dimensions include culture novelty and family/spouse adjustment.

- ***Culture Novelty:*** Culture novelty includes differences in beliefs, values, norms, religious faith, sex roles, etc. The degree of culture novelty is more, if these factors of the host country vary much from those of the home country of the expatriate. The results of the research study conducted by Ingemar Torbiorn regarding host countries ranked according to expatriate satisfaction are presented in *Exhibit 6.4*.
- ***Family-Spouse Adjustment:*** The employee may take a decision, to leave the host country before the contract expires, if the employee's spouse and

family members fail to adjust to the host country's culture. Some of the Indian housewives fail to adjust to foreign culture regarding sex and marriage system, particularly when their female children enter the teenage and force the husbands to leave the foreign job and country. However, the research studies found that:

- The spouse was in favour of accepting the assignment from the start.
- The spouse engaged in self-initiated, cross-cultural training.
- The spouse had a social support network of host country nationals.
- The standard of living in the overseas assignment was acceptable to the spouse.
- The firm sought the spouse's opinion regarding the international assignment from the beginning of the selection process.
- The spouse could adjust to the degree of culture novelty.

EXHIBIT 6.4 HOST COUNTRIES RANKED ACCORDING TO EXPATRIATE (ARITHMETIC MEAN)

Men	*Women*	*Total*
1. Switzerland	1. South Africa	1. Switzerland
2. Belgium	2. Switzerland	2. Belgium
3. England	3. France	3. South Africa
4. South Africa	4. USA	4. England
5. Portugal	5. England	5. Portugal
6. Colombia, Ecuador, Venezuela	6. Colombia, Ecuador, Venezuela	6. Colombia, Ecuador, Venezuela
7. Canada	7. Brazil	7. USA
8. Australia, New Zealand	8. Belgium	8. Brazil
9. USA	9. Mexico	9. France
10. Brazil	10. Poland	10. Canada
11. Mexico	11. South East Asia	11. Mexico
12. Spain	12. Spain	12. Spain
13. France	13. Canada	13. Holland
14. Holland	14. Holland	14. South East Asia
15. South East Asia	15. Liberia	15. Australia, New Zealand
16. West Germany	16. West Germany	16. West Germany
17. Austria	17. Italy	17. Liberia
18. Italy	18. Austria	18. Austria
19. Chile, Peru	19. Japan	19. Italy
20. East Africa (Kenya, Tanzania, Uganda)	20. Argentina, Uruguay	20. East Africa (Kenya, Tanzania, Uganda)
21. India, Pakistan	21. Australia, New Zealand	21. Argentina, Uruguay
22. Liberia	22. India, Pakistan	22. India, Pakistan
23. Argentina, Uruguay	23. Middle East	23. Chile, Peru
24. Japan	24. East Africa (Kenya, Tanzania, Uganda)	24. Japan
25. Middle East	25. Chile, Peru	25. Middle East
26. North Africa (Algeria Egypt, Morocco, Tunisia)	26. North Africa (Algeria, Egypt, Morocco, Tunisia)	26. North Africa (Algeria, Egypt, Morocco, Tunisia)

Source : Torbiorn, Ingemar, Living Abroad: Personal Adjustment and Personnel Policy in the Overseas Setting, *NY, John Wiley & Sons, Inc.*

Job Dimension

It is needless to mention that the expatriate should have required skills, knowledge and abilities to carry out the job successfully in the host country. However, certain factors help or hamper the expatriate's adjustment in the host country. These factors include:

- ***Role Clarity:*** Role clarity deals with the degree of clarity that the employee understands the job duties, responsibilities, tasks, demands and roles. High degree of clarity reduces uncertainties and help the employee to adjust to the new environment quickly. In contrast, a low degree of clarity hampers the process of employee adjustment.
- ***Role Discretion:*** Role discretion is the degree of flexibility of work place rules, regulations, expectations, procedures and policies. The expatriate's role can be significant and can influence others, if there is flexibility at work place. Otherwise, the expatriate has to adapt himself to the rules at work place. Most of the Indians adapt themselves to the workplace rules in various countries.
- ***Role Novelty*****:** Role novelty refers to the degree of distinctiveness of the duties, responsibilities, tasks etc., of the new job compared to those of the old job in the home country. The expatriate would feel it difficult and take more time, if the degree of distinctiveness is high. In contrast, the expatriate would take less time and feel it easy to adjust himself to the new job if the degree of distinctiveness is low.
- ***Role Conflict:*** Role conflict occurs when the expatriate starts receiving conflicting signals regarding his role, duties, behaviour and performance levels from the people at work place. These signals hinder the adjustment process of the expatriate.

Now, we shall study the last dimension, *i.e.*, organisational culture dimension.

Organisational Culture Dimension

Organisational culture is "pattern of basic assumptions – invented, discovered or developed by a given group as it learns to cope with its problems of external adoption and internal integration that had worked well enough to be considered valuable, and, therefore, to be taught to new members as the correct way to perceive, think and feel in relation to those problems." *(See Box 6.2)*

Every organisation has its own culture with different rules, regulations, customs, traditions, norms, expectations, etc. The expatriate is informed of the organisation culture. *Similarly*, the expatriate should also learn culture of the new organisation in the foreign country.

Culture of the new organisation is novel and it is close to the cultural novelty and role novelty. The expatriate may find it difficult during the early days of his assignment due to the cultural novelty. Slowly, he learns the organisational culture and adapts himself to the new organisational culture.

The expatriate feels that he is a member of the large corporate family when he is provided with housing, medical, conveyance, schooling for children, shopping information and such other facilities.

BOX 6.2	FLEXIBILITY IN LOCATION OF WORK PLACE
	Wide-open flexibility: Workers want a new, more fluid flexibility in work practices — versatile routines that work "whether you're 20-something and trying to earn another degree, or over 30 and taking care of children," says Carol Sladek, a principal at Hewitt Associates, Lincolnshire, Ill. Although Kevin Bourke, 30, general manager for a holding company, is still single, for example, the freedom to work from his Atlanta home was critical in selecting an employer; he wants flexibility to see his fiancée and parents, who live nearby, as much as possible, he says. At a Wilmington, Del., unit of AstraZeneca, more than two-thirds of the 30 employees in a medical-resources group are regular users of alternative setups tailored to their needs, says Donna Holder, the unit's manager; "we don't have set hours" for being in the office. The 50 employees at Motorola's technology-acceleration group in Chicago all work flexible hours from home, the office or elsewhere, says Jim O'Connor, a Motorola vice president. And at Abbott Laboratories' Columbus, Ohio, nutrition unit, where 75% of 108 employees are on flexible work setups and the rest have day-to-day flexibility, the only day everyone has to be in the office is Wednesday, says David Deis, director of research services

(D) PERFORMANCE APPRAISAL

Performance appraisal is a method of evaluating employee behaviour relating to expected work and behaviour, normally including both the quantitative and qualitative aspects of job performance. Performance refers to the degree of accomplishment of the tasks that make up an individual's job.

Appraising the employee performance on foreign jobs is a highly complicated task as the expectations of global company are multifarious. In addition, employees of various countries view the meaning of jargons quite differently. Added to this, work related practices, organisational culture and job dimensions vary from country to country. Hence, global company should take due care in appraising the performance of employees.

1. Objectives

The objectives of performance appraisal are to create and maintain a satisfactory level of performance, to contribute to the employee growth and development through training and to guide the job changes with the help of continuous ranking.

Appraisers: The appraiser may be any person who has a thorough knowledge about the job content, content to be appraised, standards of content and the one who observes the employee while performing a job. Typical appraisers are:

- Supervisors
- Peers
- Subordinates
- Consultants
- Customers (internal and/or external)
- Users of services.

2. 360° Performance Appraisal

360° performance appraisal refers to the performance appraisal of an employee by his superiors, subordinates, peers, customers, consultants and users of his services.

3. Methods of Performance Appraisal

A number of performance appraisal techniques have been developed. The traditional methods include:

- Graphic Rating Scales
- Ranking Method
- Paired Comparison Method
- Forced Distribution Method
- Check List Method
- Essay or Free From Appraisal
- Group Appraisal
- Confidential Reports.

Modern performance appraisal methods include:

- Behaviourally Anchored Rating Scales
- Assessment Centres
- Human Resource Accounting
- Management by Objectives
- Psychological Appraisal.

4. Performance Appraisal in Global Companies

Appraising the performance of expatriate employees objectively is very difficult. Performance appraisal of expatriate employees is done by both host nation managers and home country managers. The host nation's managers may be biased due to their cultural frame and expectations. In order to reduce the problems of performance appraisal, the US companies give more weightage to the self- appraisal done by the foreign employee for himself rather than by the superiors.

Japanese companies introduced participative management in Indian subsidiaries. Employees in Indian subsidiary felt that Japanese management introduced participative management as Japanese managers are incompetent. Indians view the superiors as experts, if the latter do not ask the subordinates for details. Japanese managers' performance was rated as negative by the host country's (India) superiors. Home country managers also rate the employees with a bias due to lack of face-to-face interaction.

Guidelines for Performance Appraisal: The following guidelines help to solve the problems of performance appraisal of expatriate employees.

- More weight should be given to the rating of the on-site managers' appraisal due to proximity.
- Host country managers should also give the weightage to the culture of the expatriate employee.
- Due weight should also be given to self-appraisal.

(E) TRAINING AND DEVELOPMENT

It is often said that a good selection process reduces the training effort. It might be true in the case of domestic business. But, the global companies should have enough training and development effort as the candidates are strangers not only to the jobs, but also to the soil, climate, environment, people and culture of foreign country where they are expected to work and live along with their family members.

After the candidate is selected and placed on the job, he must be provided with adequate training and developmental facilities. Training is the act of increasing the knowledge and skill of an employee for doing a particular job. Development is a systematic process of growth and by which the executives develop their abilities to manage. In fact, executive development/education has become global.

1. Importance of Training and Development for Global Jobs

Even the most valuable employees in the global companies fail to work and stay with the company due to poor training and developmental efforts. Global companies should make not only the employee, but also his family members more comfortable with the company, people and the country. Hence, training and development assume greater significance in global companies.

Training and development are the most important techniques of human resource development Training and development lead to:

- Improved job knowledge and skills at all levels of the organisation.
- Improved morale of the human resources.
- Improved profitability and/or more positive attitudes towards profit-orientation.
- Improved relationship between boss and subordinate.
- Improved understanding of culture of various countries.

2. Need for Training and Development for Global Jobs

Training and development for global jobs are necessary due to the following reasons:

- To match employee specifications with the job requirements and organisational needs.
- To achieve organisational viability and the transformation process.
- To meet the challenges of technological advances.
- To understand the organisational complexity.
- To make the employee and his family members familiar with the language, customs, traditions etc., of the foreign country.

After the employee is inducted into the company, his skills, knowledge and attitudes are moulded and developed. Training is the organised procedure by which people learn knowledge and/or skills for a definite purpose. Training improves, changes and moulds the employee's knowledge, skills, behaviour, aptitude and attitude towards the job and organisational requirements.

In case of international business, training and development refer to the development of expatriate not only towards job and organisational requirements, but also towards the host country's culture, environment and requirements. Therefore, cross-cultural training assumes greater significance in international business.

3. Cross-cultural Training

Cross-cultural training enables the expatriates to learn the cultural norms, values, aptitudes, attitudes, beliefs, behaviours, practices of the host country.

The expatriate, after training can use this cross-cultural knowledge to behave according to the cultural requirements of the host country. The adage *"Do in Rome as the Romans do"* holds good here. The trainee expatriate can transfer the knowledge gained in the training programme into new cognitive and physical behaviour. This process gives the trainee more satisfaction in their foreign assignment.

Procter and Gamble trained their selected candidates for their company in Japan regarding the Japanese culture that Japanese like more of informality, they hesitate to say no and they finalise more of their business dealings outside the office and mostly in restaurants in the evenings. The employees transferred this knowledge into their cognitive and physical behaviours and became successful in dealing with the Japanese. Thus, they became efficient in doing their jobs and interacting with the host country's nationals.

However, some companies do not train their expatriates due to the following reasons:

- Brief cross-cultural training programmes are ineffective.
- The failure of such programmes in the past resulted in employee dissatisfaction.

- Lack of enough time between selection and departure.
- High cost of training.

Though the company cannot provide training before the departure of the employee, it can plan to provide the same in the host country.

Content of the Cross-Cultural Training

It is generally accepted that cross-cultural training is effective. Landis and Brislin suggest the following content to be included in the cross-cultural training programmes. They categorised them as approaches to cross-cultural training.

- **Information of Fact Oriented Training:** The training programme provides the expatriate trainee with the information and facts of the country like country's economy, resources, languages, social groups, currency, climatic conditions, eating, dressing habits, housing, banking, insurance, medical facilities, etc.

  Training methods include lectures, video tapes, reading material, pamphlets, etc.
- **Attribution Training:** This training provides the reasons or causes for the behaviour of the people of the host country. *For example, Japanese do not say 'No', because they want to respect the other's feelings and do not want to hurt the others. Similarly, Americans respond straight and do not hesitate to say 'No.' This is because they want to communicate clearly.*

Goal of this training is to understand the values, norms and perceptual maps. Once the culture and the reasons for it is understood, the expatriates are encouraged to adapt their behaviour to the norms of host country.

Indian expatriates in the USA are given brief training regarding punctuality, perfectness in work, etc. and the reasons for such behaviour. Almost all the Indian expatriates adapt themselves to this cultural norms within no time.

- **Cultural Awareness Training:** This training is to provide the common values, attitudes and behaviour in the host country's culture. This makes the trainees to understand how culture affects the behaviour of the people of the host country.
- **Cognitive-Behaviour Modification Training:** This training provides the information regarding the behavioural practices which result in getting rewards or punishments in the host country. Then the trainees compare the rewarding or punishing practices in the home country and host country and formulate the strategies for their behaviour in order to maximise rewards and avoid punishments in the host country.

For example, Indian organisational and corporate environment do not provide any rewards for employee commitment, hard work, sincerity and productivity. Similarly, it does not provide punishments also for poor commitment, insincerity and low productivity. When the Indians go to the USA, they understand that the US corporate culture is opposite to that of India. Hence, they select the strategy of *becoming a committed, hardworking and sincere employee in US corporations in order to get more rewards and avoid punishments including firing.*

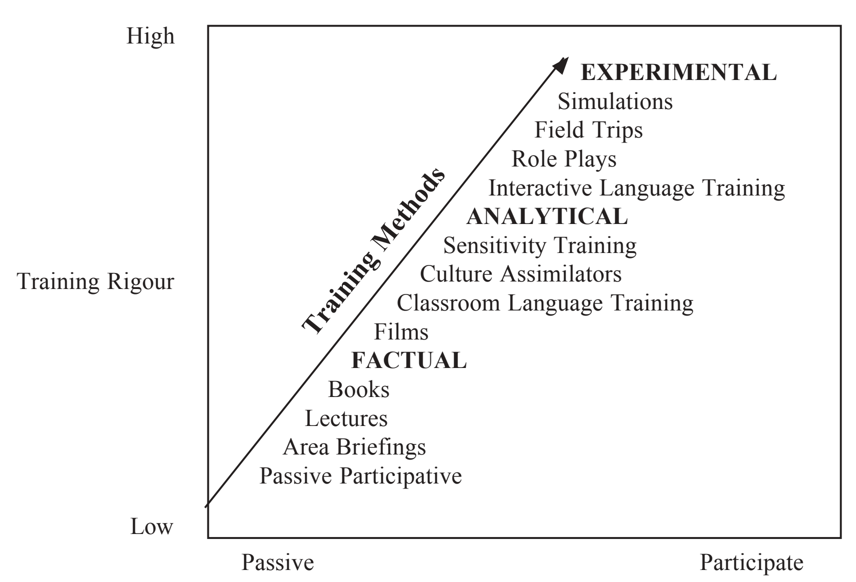
- **Experimental Training:** The expatriates in this programme are exposed to real life situations through field visits, visits to the host country, complex role plays and cross-cultural simulations. This gives the trainees the real life experiences.

Training Techniques: Most commonly used training techniques include:

- Lectures
- Area briefings
- Reading Material
- Video films
- Classroom Language Training
- Case Studies
- Sensitive Training
- Role Plays
- Field Trips
- Simulations
- Interactive Language Training
- Cultural Assimilators.

Exhibit 6.5 presents the techniques of cross-cultural training.

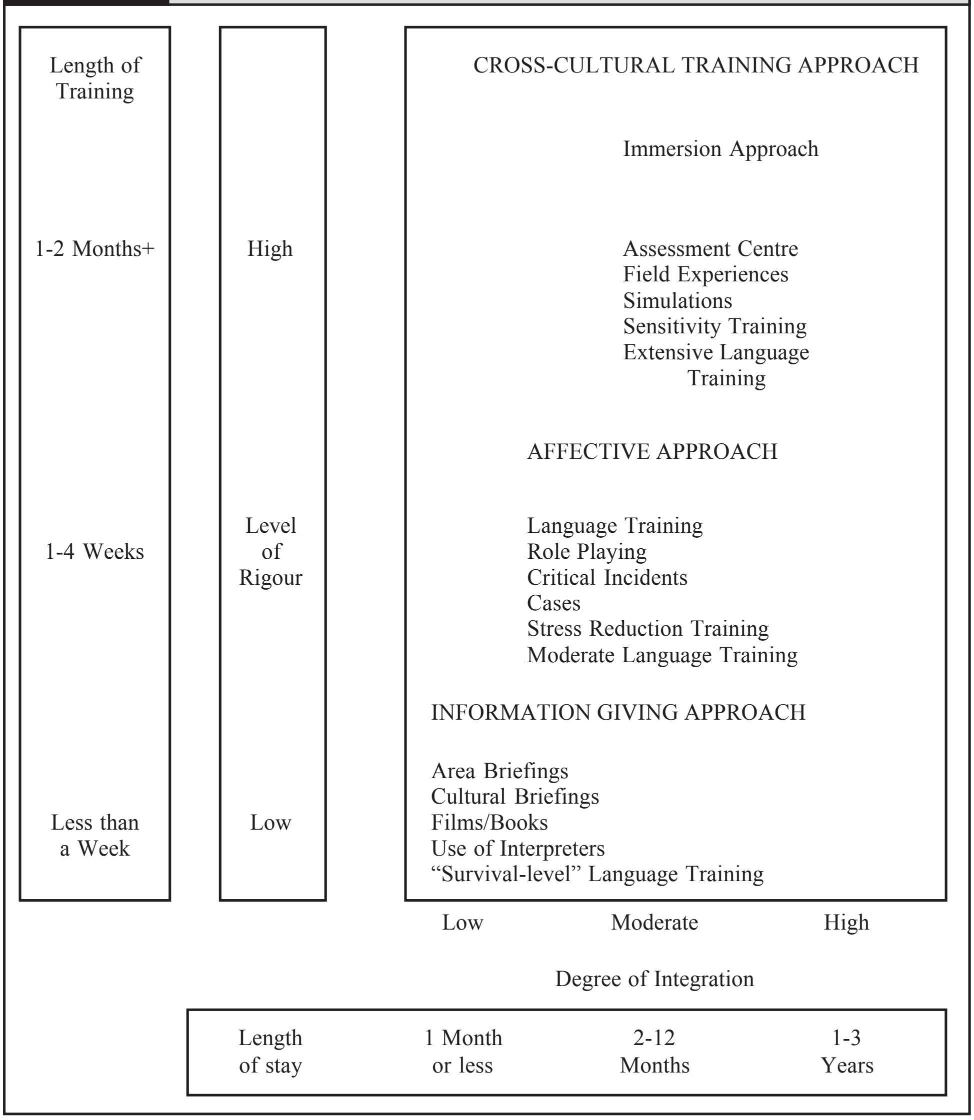
EXHIBIT 6.5 TECHNIQUES OF CROSS-CULTURAL TRAINING



Source : Black, J.S. & Mendenhall, 1989, *"A Practical but Theory-based Framework for Selecting Cross-cultural Training Programs," Human Resource Management,* 28 (4), pp. 511-539.

- **Rigorous Training:** Some training techniques like role plays, simulations need rigorous training while other techniques need mere participation of the trainee in the programme. *Exhibit 6.6 presents the relationship between rigorous training and the level of participation of the trainee.*

EXHIBIT 6.6 RELATIONSHIP BETWEEN RIGOROUS TRAINING AND THE LEVEL OF PARTICIPATION OF THE TRAINEE



Source: Mendenhall, M. & Oddou, G. 1986, "Acculturation Profiles of Expatriate Managers: Implications for Cross-cultural Training Programs," Columbia Journal of World Business, *Winter, pp. 73-79.*

Human resource managers in international business companies have the dilemma in deciding which programme requires rigorous training. The following variables help the human resource manager in solving this problem.

- **Job Novelty:** We have already discussed what the job novelty is? The expatriate trainee needs rigorous training and more assistance, if the job is more novel. The novel job would be challenging and therefore, the expatriate needs to be trained in the cross cultural managerial skills necessary to do the job efficiently.
- **Interaction with Host Nationals:** If the degree of interaction of the expatriate with the host country's customers, work force, government officials, suppliers, bankers, industry leaders and the like, is high the training should be rigorous.

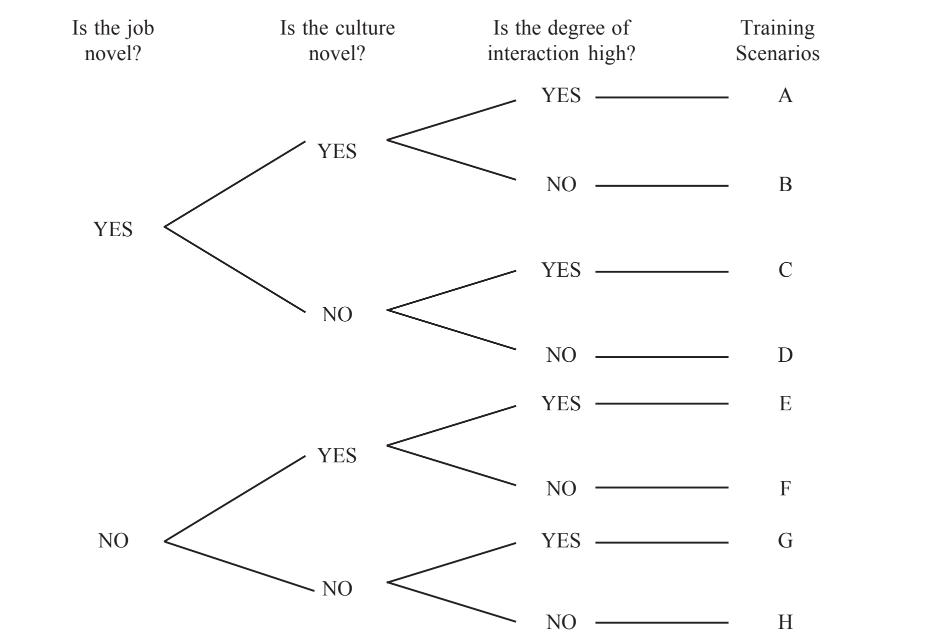
Other factors to be considered are:

- Degree of familiarity of the norms of host country's culture.
- Importance of the interaction to the company.
- **Culture Novelty:** We have already discussed the cultural novelty. It is very difficult to adjust with the highly novel culture.

  For example, it is, highly difficult for the Indians to adjust with the culture of Maldive as the culture of Maldive is quite different from that of India. It would be difficult to the trainees to absorb the novel cultures. In such cases the training should be rigorous.

Exhibit 6.7 shows decision tree for selecting appropriate training methods *vis-a-vis* the degree of culture novelty, job novelty and degree of interaction.

EXHIBIT 6.7 DECISION TREE FOR SELECTING APPROPRIATE TRAINING METHODS



Source : Mark Mendenhall, Betty Jane Punmett and David Ricks, op. cit.*, p. 452.*

Black and Mendenhall argue that the greater the cultural novelty, required degree of interaction with host nationals and job novelty, the greater the need for cross-cultural training. Each of these dimensions are not equal. According to them adjusting to the host culture and interacting with the host nationals are more difficult than adjusting to the international job. *Exhibit 6.8 presents a framework of training scenario. This framework can also be used for training the employee spouse and children.*

EXHIBIT 6.8 TRAINING SCENARIO

A	*Level of Rigour:*	High
	Duration:	60-180 hours
	Approach:	Lectures, factual briefing, books, culture assimilator, role plays, cases, simulations, field experience
	Training Content:	Equal emphasis on job and culture. Stress job demands, constraints, and choices include economic, political, historical, and religious topics
B	*Level of Rigour*:	Moderate
	Duration:	20-60 hours
	Approach:	Lectures, films, books, culture assimilator, cases
	Training Content:	Equal emphasis on job and culture
C	*Level of Rigour:*	Moderate
	Duration:	20-60 hours
	Approach:	Lectures, films, books, cases, role plays, and simulation
	Training Content:	Strong emphasis on job demands, constraints, and choices; less on culture
D	*Level of Rigour:*	Low to moderate
	Duration:	20-40 hours
	Approach:	Lectures, factual briefing, cases
	Training Content:	Strong emphasis on jobs but little emphasis on culture
E	*Level of Rigour:*	Moderate
	Duration:	40-80 hours
	Approach:	Lectures, films, books, culture assimilator, cases, role play, simulation
	Training Content:	Little emphasis on job; most emphasis on culture, including economic, political, historical, and religious aspects
F	*Level of Rigour:*	Low to moderate
	Duration:	30-60 hours
	Approach:	Lectures, films, books, cases
	Training Content:	Little emphasis on job more emphasis on culture
G	*Level of Rigour:*	Low to moderate
	Duration:	30-60 hours
	Approach:	Lectures, films, books, cases, role plays
	Training Content:	Little emphasis on job but more emphasis on culture
H	*Level of Rigour:*	Low
	Duration:	4-8 hours
	Approach:	Lectures, films, books
	Training Content:	Little emphasis on either job or culture

Source : Ibid., p 453.

Blunders in Cross-Cultural Training

Cross-cultural training is essential to make the new employee to adjust with the new culture of the job, company and host country. The expatriates with such training proved to be efficient than those who did not receive the training. Cross-cultural training is not necessary for long-term expatriates. Research studies indicate the failures when the cross-cultural training is not provided. *Exhibit 6.9 provides example of failures, in case cross-cultural training is not provided.*

EXHIBIT 6.9 EXAMPLES OF FAILURE OF CULTURAL ADJUSTMENTS

- The new American owners of a Spanish company changed the firm's previous prestigious Spanish name to that of the U.S. parent, flew the American flag from the company flagpole... the company even suggested that those who had managed the company prior to thetakeover by the Americans were incompetent.… The blunder was so serious that it resulted in a general slowdown of work (strikes were then officially banned).…The result: The newly acquired subsidiary lost a great deal of its previous business
- An executive from Lucerne, Switzerland, negotiating a business venture with a Japanese firm failed to recognize the importance of personal sentiment to the Japanese and he paid the price. The president of the Japanese company sponsored a party in Tokyo and exclaimed, "I will not do business with a man who does not like us!" The executive believed he had concealed his dislike for the Japanese during his stay, but the president of the Japanese company had seen through his mask
- An American manager who understood little German was sent to Germany to discuss marketing plans with the local German subsidiary managers. The local managers, however, spoke little English. Both sides tried to understand each other, but neither nationality did very well. Eventually they parted, thinking they were in agreement. It was later discovered that during the meeting many important points were overlooked, and the company subsequently lost numerous sales opportunities
- A Brazilian expatriate executive created major problems for his firm when he treated his secretaries in America as personal servants. Not only did he ask them to do his personal shopping, but he even asked them to mend his clothes!
- An American executive was to conduct a presentation for the Prime Minister and his cabinet of a small Caribbean country. The meeting was held in the Prime Minister's conference room, and the executive began his presentation with, "Honorable Mr. Tollis and esteemed members of the cabinet." The Prime Minister interrupted him several times and asked him to start over. Eventually, someone advised the bewildered and then embarrassed businessman that Mr. Tollis had been deposed six months earlier!

Source : "Big Business Blunders: Mistakes in Multinational Marketing," Dow-Jones Irwin, and M. Mendenhall, D.Rides, et al., op. cit.*, p 458.*

(F) COMPENSATION AND BENEFITS

Compensation is the amount of remuneration paid by the employer to the employees in return to their services and contributions to the company. Compensation is the most important factor in the entire human resource management process. Compensation includes the amount of salary, the different kinds of fringe benefits and employees welfare benefits, bonus, profit sharing, stock options and the like.

A number of factors affect the compensation policy of global companies. The important among them are: compensation levels in comparable global companies, company's ability to pay, cost of living in various countries, employer productivity, trade union's pressure and strategies.

Global companies give a number of benefits to its employees in addition to the salary. These benefits include: air fare, paid leave, medical allowance, conveyance allowance, educational allowance for employees' children, gratuity, resettlement allowance, profit sharing, employees stock options, etc.

Compensation in Global Companies

Compensation is the amount of remuneration paid to the employees. The two issues involved in compensation management are: national economic differences and payment practices. The second issue is the mode to payment to expatriate managers. There are significant differences in the compensation levels and structures among different countries. This is because, the firms pay the executives of various countries based on the local compensation levels.

- **Expatriate Pay:** Expatriate pay is mostly based on the balance sheet approach. Under the balance sheet approach, the compensation package enables the expatriate employees in various countries to maintain the same standard of living. This approach also provides for offsetting quantitative differences among employment locations.
- **Gratuity:** Expatriate employees are paid gratuity at a fixed rate for every year of completion of service in the foreign country.

Gratuity is the inducement to the expatriates to work for quite longer period in the foreign country.

- **Allowances:** Expatriate employees are paid various allowances like car allowance, resettlement allowance, housing allowance, hardship allowance, cost-of-living allowance, education allowance, medical allowance, etc.
- **Taxation:** Some countries pay tax-free salary and/or tax-free gratuity. Most of the countries pay taxable salary and gratuity.

Compensation for overseas personnel include:

Compensation of Overseas Personnel

Home Country Salary
- Salary
- Income tax benefits
- Housing
- Goods and Services
- Reserves

Host Country Costs
- Salary
- Income tax benefits
- Housing
- Goods and Services
- Reserves

Host Country Equivalent
- Purchasing Power
- Premiums
- Incentives
- Gratuity

Profit Sharing and ESOP

The multinational corporations in order to motivate the employees for higher performance introduced a scheme of profit sharing. Under this scheme, workers get a right to have a share in the net profit of the company if the profits cross a certain limit. This provision motivates the employees to improve production, sales and profits.

Multinational corporations also introduced another plan to motivate the employees and to retain them. The expert and efficient employees go on shifting to the other organisations which pay higher salary and offers better facilities. This problem is more acute in software and information technology firms. These companies introduced the 'Employee Stock Ownership Plan' in order to reduce employee turnover and retain them in the company.

The Employee Stock Ownership Plan (ESOP) allows the employees to purchase the share (or stock) of the company at a fixed and reduced price. Employees are motivated when the company allows them to buy the shares at concessional price. The stock ownership is viewed as performance based incentives. This plan is described as "golden hand-cuffs."

The advantages of stock ownership include:

- This plan links compensation package closely to performance.
- The plan enables the MNCs to retain efficient employees with them.
- It encourages the employees to improve their performance.
- This scheme establishes significance of team effort among employees.
- It increases employee involvement and participation.

ESOP is used by various companies in India, USA, Australia, Japan, Italy, France, Spain, Sweden, Norway, the UK etc.

(G) WOMEN IN INTERNATIONAL BUSINESS

Women recently started playing a vital role in international business. However, the role of women is not equal to that of men even today. The role of women in economic activities varies from country to country. The following examples indicate the role of women in different countries:

- In Saudi Arabia restrictions on women's freedom to move around make it difficult for women to work. *For example*, women are not permitted to drive, to travel on an airplane alone, or to stay in a hotel without a male family member.
- In Japan women seldom work after marriage; consequently, women are unlikely to progress far within oganisations.
- In the U.S., women have attained a degree of equality in business, but they are seldom found in top management positions.
- In Ireland, the constitution has been interpreted to mean that a woman should only join the workforce if her husband is not able to look after the family economically.
- In St. Vincent, a West Indies island country, the minimum wage for women is lower than for men, regardless of the work performed.
- In Canada, the great majority of nurses and secretaries are women while the majority of fire fighters, construction workers, and foresters are men.
- In the People's Republic of China women hold many of the same positions as men, but they are required to retire at an earlier age.
- Ramachandran (1992) gives this example of the role of women in parts of India: in Rajasthan, when a social work organisation wanted to establish a hospital for women, there was a great deal of hostility and resistance. The village men could not understand why so much fuss should be made over women; they insisted that what they really needed was a hospital for their farm animals."

International business managers should understand the role of women in economic activity and in business in various countries they operate. They have to consider various issues in employing women. Understanding working with women is more complicated than working with men. Therefore, managers should understand the role of women in business in various countries. Now we discuss the role of women in business.*(See Box 6.3)*

Examples of Women's Role in Business

- Women are employed in Tea and Rubber plantations along with the family members by the transnational corporations.
- Transnational banks and service organisations employed women in white-collar occupations. However, most of the women occupy lower level jobs.
- Export-Processing Zones (EPZs) of Transnational companies employed women significantly. Most of the women in these operations work as low-paid, unskilled, or semi-skilled workers.
- It is difficult for western corporations to understand and accept women employees in business in Arabian peninsula. The married women in Saudi Arabia can visit close friends, or relatives, and go to shops only. But a male

relative should accompany them. Women are not permitted to work with men in Saudi Arabia.

- *Team Work and Productivity:* Japanese culture motivates the employees to work in a team and carry along with the group which results in synergy. This in turn enhances the employee productivity. On the other hand, the culture of the USA and European countries make the employees to work individually and as such deprives the benefits of synergy. Hence, the productivity in Western industries had been less than that of Japanese. However, the longer working hours enabled the US labour to surpass the productivity of their counterparts in EU and Japan.

BOX 6.3 WHAT IS THE LEVEL OF WOMEN'S PARTICIPATION IN THE WORKFORCE?

The information technology industry in particular is an industry where the numbers of women are low, and even lower in senior management positions. In the US, where women make up approximately 50% of the workforce and hold 45.9% of all U.S. managerial positions, they hold 9.3% of board seats at technology companies compared to 12.4% at non-tech companies. Women also represent 11% of corporate-officer positions in tech companies, 15.7% in non-tech companies.

In fact, in the US industry, the percentage of women in the IT workforce is decreasing. In 1996, women made up 41 percent of I.T. workers, but by 2002 that figure had dropped to 35 percent, and according to some, the rate of decrease is continuing.

However, it should be noted that in India, the percentage of women in the IT workforce appears to be increasing. participation of women in IT is low in India, but gradually increasing as they constitute 21% of total 650,000 IT workers in the country in 2003 when compared to 15% in 2001. The enrollment of women in engineering is low and gradually increasing from 7.6% in 1989-1990 to 16.2% in 1999-2000. Further work needs to be done on understanding the reasons for this trend.

- In Bahrain women are educated and are given equal opportunity. But they are discouraged from seeking employment.
- Steps are taken to encourage women employment in Oman.
- In Hong Kong women are found in all organisational levels. They are effective business people. Mostly women are in secretarial positions.
- In Malaysia, though equal opportunity is given to women, they normally do not enter business.
- In Singapore women employment is quite common. Eighty per cent of the women work force is in the age group of 10 to 24 years. Professional women are in government service. However, they play subordinate role to men.
- In South Korea women rarely enter business. The prospects for their advancement are slim. Mostly they are employed until the age of 30 or till they marry.

- In Thailand women are seen as "the hind legs of the elephant" — powerful but following — and are in subordinate positions. However, some women hold top positions in government and private business.
- In People's Republic of China almost all women work. The Government provided extensive educational facilities for women. Women in China work in scientific profession and governmental organisations also.
- Traditionally women in Japan worked in lower paid and lower level positions. University toppers were also appointed for clerical jobs. Japanese Government in 1986 passed Anti-discrimination legislation prohibiting discrimination based on sex. Now the position is improved and women are treated equally with men in government and public sector organisations. However, the traditional role of woman looking after the family after marriage is still accepted.
- In European Union the situation varies from country to country. Women in Denmark get 32 weeks of maternity leave while women in Greece get 15 weeks and in Spain 16 weeks. Most of the European countries, at least, are attempting to promote equal opportunities for women.
- **USA and Canada:** Situation in the USA and Canada is better compared to women employment in almost all the other countries in the world. However, women work in jobs subordinate to men in the USA and Canada. Discrimination based on sex is prohibited in both the countries. Absence of women at the top level is due to:
  - Past discrimination
  - On-going discrimination
  - Lack of interest on the part of some women
  - Shortage of women with required educational qualifications and training.
- **In Africa:** Women in Africa mostly confine to domestic activities. Women, in some places, even do not see the men directly when they transact with them.

Now, we shall discuss the role of dual career groups in international business.

(H) DUAL CAREER GROUPS

Though the dual career groups play vital role in international business, many international business organisations have not been paying adequate attention to it. This trend is due to the problems with them when there is dislocation of one of the spouses. However, international business firms should develop a positive policy to make use of the best human resources by encouraging dual career groups and women expatriates.

The managements of international business firms should be proactive in making use of dual career groups. The proactive approaches include:

- Development of career-oriented employment networks.
- Provide the services of job-search firms.
- Provide more time to the employee so that the spouse can find a job.
- Establish education fund to acquire training.
- Provide help for professional employment opportunities.
- Provide activities to the spouses based on their aptitude.
- Provide realistic pre-departure information on foreign job opportunities.
- Address the questions of unemployment, benefits, pension, etc.
- Spouses have to be flexible in finding a broad area of appropriate employment for them.

After having a brief discussion on women in international business, it would be apt for us to discuss industrial relations in international business.

(I) INTERNATIONAL INDUSTRIAL RELATIONS

Industrial relations mean the relationship between employees and management in day-to-day working of industry. Industrial relations is a whole field of relationship that exists because of the necessary collaboration of men and women in the employment process of an industry.

Industrial relation is the complex relations among the following parties:

- Employees
- Employees' unions
- Employer
- Employers' Associations
- Government.

Industrial relations is the outcome of the practices of human resources management. In fact, industrial relations outcome provides the basis for reformulation of human resources management policies. The important areas of industrial relations are:

- Trade Unions
- Grievance Procedure
- Disciplinary Procedure
- Collective Bargaining
- Industrial Conflicts including Strikes and Lockouts
- Workers' Participation in Management
- Quality Circles
- Quality of Worklife
- Profit Sharing and Employee Ownerships/Employee Stock Option.

Almost all of you know the meaning of the above-mentioned concepts of industrial relations. As such, we shift our attention to discuss the international scenario of industrial relations.

Trade unions generally represent the workers' problems in collective bargaining. In most of the countries including India, the USA, the UK, Japan, etc., trade unions negotiate with the management representatives in collective bargaining in order to reach collective agreements and see that the management implements the agreements. However, trade unions fail to influence the management for fair labour practices.

But, this responsibility, in Germany is taken up by works councils comprised of both employees and employer representatives. These works councils have the responsibility of collective bargaining at the organisational level only. However, at the industry level, the trade unions take the responsibility of collective bargaining. Work councils decide upon various issues like:

- Working conditions
- Standard of employee conduct
- Wage rates

Unsolved issues at works councils level are settled through arbitration Works councils in Germany are more powerful with a strong view that employees and employers have a common welfare.

Industrial Relations Strategies of MNCs

Multinational corporations have to deal with the employees of various countries with varied cultural, social, political and religious environments. The industrial relations strategy of the MNCs are mostly applied to the environment of only one country and it has to formulate another strategy for another country. Industrial relations are seen in the larger interest of social class struggle in Switzerland, France and Italy. In most of the other countries this is seen only as the relationship between workers and management.

MNCs decentralise their industrial relations policies and practices. MNCs use the strategy of relegating the industrial relations problems like work stoppages, strikes, etc., to the specialists in the various countries. Employees working in various subsidiaries of MNCs formed international trade union. *(See Box 6.4)*.

BOX 6.4 WHO ARE THE WORLD'S LARGEST MNC EMPLOYERS?

Giant retailer Wal-Mart Stores, with 1.8 million employees, tops the first published list of the world's 500 largest corporate employers. Home to nearly half of the companies on the list, the United States boasts the largest employers in 13 out of 28 industries.

Topping the list are these giant enterprises:

1. Wal-Mart Stores, United States, 1,800,000 employees
2. Deutsche Post, Germany, 502,545 employees

3.	Siemens Group, Germany, 461,000 employees
4.	McDonald's, United States, 447,000 employees
5.	Carrefour, France, 440,479 employees
6.	Compass Group, United Kingdom, 410,074 employees
7.	United Parcel Service, United States, 407,000 employees
8.	Gazprom, Russia, 396,571 employees
9.	DaimlerChrysler, Germany, 382,724 employees
10.	Hitachi, Japan, 355,879 employees

Source: Fortune 500 Companies

(J) QUALITY CIRCLES

Quality circle is a small group of employees in the same work area or doing similar type of work who voluntarily meet regularly for about an hour every week to identify, analyse and resolve work related problems not only to improve quality, productivity and total performance of the organisation but also to enrich the quality of work life of employees.

Dr. Deming opines that many MNCs adopted quality circles without understanding what they are doing? He suggests 12 points for their successful functioning in the MNCs. They are:

- Achieve consultancy of purpose
- Learn a new philosophy
- Do not depend on mass inspections
- Reduce the number of vendors
- Recognise two sources of faults, *viz.*, management and production systems, and production workers.
- Improve On-the-job training
- Drive out fear
- Improve communication
- Consider work standards carefully
- Teach statistical methods
- Encourage new skills
- Use statistical knowledge.

(K) PARTICIPATIVE MANAGEMENT

Participative management is a system of communication and consultation either formal or informal by which employees of an organisation are kept informed about the affairs of the undertaking and through which they express their opinions, ideas, suggestions, contribute to the development of alternative solutions, evaluate them and help the management in decision-making.

Now, we discuss the evolution of the concept of participative management and participative management practices in various countries.

Evolution of the Concept of Participative Management

Viewed from the global perspective, the institutional culmination of the concept of workers' participation began with the establishment of joint committees of workers and management in several European countries towards the end of the World-War-I.

Historically speaking, the earliest institutional form of participation was the Worker-Management Joint Committees which were set up in the British Municipal Undertakings following the recommendations of the Whitely Report submitted in 1916. Subsequently, other countries such as the U.S.A., France, Sweden, West Germany, Poland, and Yugoslavia also made attempts to introduce scheme of workers' participation in management.

The initial interest in and enthusiasm about, participative management declined between the two world wars. After World War II, attention was paid to workers participation in management through successive phases of tide and ebb in the subsequent decades. In most countries including the developing ones, a renewed push towards participatory management seems to have begun by the end of 1950s.

The schemes of participation have assumed a variety of forms and structure in different countries. It is said that the cross country divergence relating to workers participation in management has resulted largely from the difference in the political set up, governmental goals and values, economic and industrial structure and the aspect of socio-political culture of a particular country. However, a study of the workers' participation in management in various countries will provide the factors responsible for its development.

Joint Consultative Machinery in the United Kingdom

The idea of the workers participation in the United Kingdom (U.K.) began and grew with industrialisation itself and was the result partly of the compulsion of socialistic thought and partly due to the humanitarian attitude of some of the employers during the eighteenth century who realised the difficulties of the workers and tried to help them by holding informal discussions with representatives of workers. Joint consultation and collective bargaining go together in the industrial relations system in the U.K. Joint Consultation (in the form of Joint Councils) in the British industries emerged with the recommendations of the Whitely Committee which was appointed by the Government. As the term indicates it is consultative, and the areas of discussions were confined mostly to health, welfare and safety of the employees. Both the parties lost interest as the councils had no administrative powers.

Collective Bargaining in the U.K. is largely a decision-making process between the management and the trade unions. However, collective bargaining, which often proceeds with intensive power struggle, has a deteriorating effect on the industrial relations climate. The entire process is also based on mistrust, concealment of true introduction, misunderstanding and the use of negative pressure tactics. In the U.K. both joint consultation and collective bargaining are not very successful.

Federal Republic of Germany

The development of workers' participation in management is not an exclusively post-war phenomenon as Works Councils can be traced back to Bismark, and were developed in the early nineteenth century only in the erstwhile West Germany. But they were suppressed by the Nazis, and resurrected in the post-war period. The revival came with the name Co-determination. The Government played a key role by legalising the scheme, though it was introduced because of trade union demands. Though the scheme was initially introduced in coal and steel industries. it was later extended to other industries.

Though the role of trade unions in the erstwhile West Germany is limited in co-determination, they play a major role in collective bargaining process. Collective bargaining generally takes place at the industry level on issues like wages and working conditions, whereas co-determination and works councils take place at the enterprise level. Though it is said that the works councils cannot enter into the areas of collective bargaining, they have gradually enlarged their operations and encroached on the areas of collective bargaining in practice.

Yugoslavian Self Management

The Yugoslavian system makes a distinction between workers' participation in management and the concept of self-management. The latter style gives complete control to workers to manage directly all aspects of industries through their representatives. The scheme introduced was a post-World War II development. The important bodies under self-management are: Workers' Council, Management Board, Director and Peoples' Committee.

Workers' council is the highest authority at the enterprise level. It consists of employees' representatives, elected for three years. The important functions of the council include planning, operations, financial management, and supervision of the work of the Management Board.

The Management Board serves as the executive organ of the workers' council. The members of the board are elected from amongst the members of the workers' council for a term of one year, with the exception of the Director, who is only an ex-officio member.

The Director is at the apex level of the organisational structure. He is selected by the council and local peoples' committee through competition for a term of four years. He is responsible for implementing the decisions of the Council and Board.

The peoples' committee, comprising local people, plays an advisory role to the workers' council. The committee has a role in the appointment of director and also provides funds for the investment and payment of minimum wages.

Except these, the trade unions at the enterprise level have no direct role in the self-management but, they have the right to submit lists of candidates for worker's council and their approval is necessary for the council's decisions relating to wages, distribution of surplus, etc. In spite of this trade unions are considered to be the basic organisation of the working class implementing and promoting self-management.

Though self-management gives control to workers to manage all aspects, in practice, as found by Kolaja, workers are more concerned with day-to-day affairs. There is a sense of faith and belonging in the workers towards the system and the enterprise. These have contributed to making self-management a success and helped in preventing workers' exploitation.

The United States of America (U.S.A.)

Collective bargaining is much widely used in the U.S.A. as the chief means for industrial democracy. Sturmthal observes: "the belief that collective bargaining is the main road towards industrial democracy, and that the collective agreement in its widest sense is its principal expression, is almost unchallenged by contemporary thought in the United States."

A recent innovation in the U.S. enterprises is to develop co-operation which takes the form of joint management committees, production committees, etc., profit-sharing schemes as per Scanlon plan have become another means of fostering co-operation between workers and management. In addition, experiments on the quality of work-life emphasising work-linked democracy are also going on. The idea behind these schemes is to extend collective bargaining beyond its traditional limits. The objective is to obtain benefits for both parties and not to bargain over the decision of gains.

Collective bargaining is the most effective way in which workers through their trade unions influence managerial decision-making. Most of the workers and trade unions are not interested in formal participation in management. The presence of mutual trust and dependence, effective communication between the parties and single, strong, democratic and enlightened trade union with an enlightened work force have greatly contributed to the success of the American style of industrial democracy.

To sum up, the term participative management differs from country to country. The form and content also vary from country to country based on the social, political and economic mileu of a country.

POINTS TO BE REMEMBERED

- Examples of international business firms are of different nationals like parent country nationals, host country nationals, third country nationals, expatriates.
- The different stages of adjustment of employee and his family to the foreign culture include: honeymoon stage, culture shock stage, adjustment stage and mastery stage.
- Dimensions of international adjustment of employee and his family include: individual dimension, job dimension, organisational culture dimension and non-work-dimension.
- Foreign nationals are trained and developed in the job areas and cultural areas.
- Cross-cultural training areas include: fact oriented, attribution, culture awareness, cognitive behaviour modification, job novelty, etc.
- Women play significant role in international business. However, there are different restrictions on the freedom of women to take up employment across the jobs.
- International business houses should encourage dual career groups for employment stability.
- Industrial relations situation vary from country to country. However, the role of industrial relations is declining in international business.

KEY WORDS

- Human Resource
- Parent Country Nationals
- Host Country Nationals
- Third Country Nationals
- Expatriates
- Honeymoon Stage
- Culture Shock
- Mastery Stage
- Mentor
- Self-efficiency Skills
- Organisational Culture
- Attribution Training
- Dual Career Groups
- Quality Circles
- Participative Management

QUESTIONS FOR DISCUSSION

1. What is human resource management? Explain important functions of human resource management.
2. Discuss the distinct concept of international human resource management.
3. Why do the employees and their family members need adjustment in international assignment?
4. Explain the different stages of international adjustment.
5. Discuss in detail the various dimensions of international adjustment.
6. What is organisational culture? How do the employers learn the culture of foreign companies?

7. What is cross-cultural training?
8. List out a few blunders of cross-cultural training? Explain the steps to be taken to prevent such blunders.
9. Explain the role of women in international business in various countries.
10. Discuss the industrial relations scenario in a Multinational Corporation and in various countries of the globe.

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Unit Seven

REGIONAL TRADE BLOCKS

CHAPTER OUTLINE

(A) ECONOMIC INTEGRATION

Some countries create business opportunities for themselves by integrating their economies in order to avoid unnecessary competition among themselves and also from other countries. Economic integration among countries takes several forms. It covers different kinds of arrangements between or among countries by which two or more countries link their economies closer either in part of total. They maintain the cohesiveness among or between the countries through tariffs. They discriminate against the other countries, which are not parties to the agreement, through tariffs. They also discriminate against the goods produced by other countries. Economic integration varies in degrees.

Different kinds of Economic Integration

Economic integration among the world economies varies in degree. They are:

- **Free Trade Area :** If a group of countries agree to abolish all trade restrictions and barriers among or charge low rates of tariffs in carrying out international trade, such a group is called, 'free trade area.' These countries impose trade barriers and restrictions with regard to trade with countries other than the members of the group independently.

- **Customs Union :** The member countries of the customs union have two basic features. They are: *(i)* The member countries abolish all the restrictions and barriers on trade among themselves or charge low rates of tariffs and *(ii)* they adopt a uniform commercial policy of barriers and restrictions jointly with regard to the trade with the non-member countries. Thus, customs union is advanced in degree compared to a free trade area.
- **Common Market :** Common market has three basic characteristics. They are: *(i)* All member countries abolish all the restrictions and barriers on trade among themselves or charge low rates of tariffs. *(ii)* They adopt a uniform commercial policy of barriers and restrictions jointly with regard to the trade with the non-member countries, and *(iii)* They allow free movement of human resources and capital among the member countries. Thus, common market is superior to customs union.
- **Economic Union :** Economic union has four basic characteristics. They are: *(i)* All member countries abolish all the restrictions on trade among themselves or charge low rates of tariffs.*(ii)* They adopt a uniform commercial policy of barriers with regard to trade with the non-member countries. *(iii)* They allow free moment of human resources and capital among themselves and *(iv)* They achieve uniformity in monetary policy and fiscal policy among the member countries. Thus, economic union is superior to common market.

  In a nutshell, Economic Union > Common Market > Customs Union > Free Trade Area.

Regional Approach

As we have discussed, economic integration takes different forms like free trade area, customs union, common market and economic union. The member countries of the group adopt a system of preferential tariffs like lower rates of duty on imports. *For example,* the UK and its commonwealth countries operated a system of reciprocal tariff preferences after 1919.

In a free trade area, the members charge low rates of tariff or abolish them regarding the trade among themselves and different countries charge different rates to non-members. European Free Trade Association, is an example. As stated earlier, the members charge uniform rates of tariffs with regard to non-member countries. The 19th century German Zollverein is an example of customs union.

The approach towards regional integration has been increasing throughout the globe. Economic integration results in grouping up of smaller economies into a larger and single economy and market. Economic integration minimises the economic consequences of politically independent countries and political boundaries.

Advantages of Integration

The economic integration of the countries of the same region or areas increases the size of market, aggregate demand for products and services, quantity of production, employment and ultimately the economic activity of the region. Further, the people of the region get a variety of products at comparatively lower prices. This factor, in turn, enhances the purchasing power and living standards of the people.

- The resources of the region are pooled. In other words the factors of production of the countries are combined. The pooling increases efficiency of output or productivity due to large-scale economies. Further, it enables to have economies of division of labour and specialisation.
- Rapid technological innovations and development and consequent large size operations demand heavy investment. Economic integration enables the group of countries to pool required financial resources for the large-scale operations. Internal reallocation of financial resources takes place based on the reallocation of manufacturing facilities and consumption pattern.
- The elimination or reduction of tariffs and barriers reduces the import duties and thereby reduces the prices of the products/services. Customer gets the advantage of having the product at lesser price.

Trade Creation and Diversion

The trade impacts of trade blocks are normally measured by weighing the benefits of trade creation against the adverse effects of trade diversion. Trade creation occurs when lower-cost partner country imports displace higher-priced domestic production, and thereby decrease costs of production and consumer prices within the country. Trade diversion happens when lower-cost imports from outside the block are displaced by higher-cost imports from within the block.

Generally, trade creation and welfare benefits are greater, the higher the trade barriers being reduced and the larger the reduction in barriers; the larger the partner countries; the larger the number of partners; the more diversified the economies of the partner countries; and the close the partner's prices are to world prices or the more competitive they are compared to countries outside the block (Laird 1999). Benefits are also greater when the partner country is not only large and rich, and has a complementary trading pattern, but is also fast growing.

The following example clarifies the trade diversion concept. Suppose the home country can import a can of beer from a potential partner country at \$1.20 per can and from a non–partner country at \$1 per can. If the tariff on both is 40 cents per can, the price paid by the home consumer would be \$1.60 and \$1.40 for a can from the partner and non-partner, respectively. Consumer would thus prefer to buy from the non-partner. Now suppose that due to a preferential trade agreement the duty is reduced to zero for the partner, but not for the non-partner. The price for the partner now declines to \$1.20 and the consumers shift from the non-partner to the partner country. While for the consumer the price is 20 cents cheaper, the government looses 40 cents in revenue per can. The net effect on the country is 20 – 40 = –20 cents, i.e., a loss of 20 cents. The price charged by the partner need not fall to \$1.20 – as long as the price is less than \$1.40 the partner would out compete the non-partner. If, say, the price fell to \$1.30, the consumer would gain only 10 and the loss to the country would be 30 cents.

Having discussed the different types of economic integration, regional approach and the advantages of economic integration, now we shall discuss different economic integrations or trade blocks. The most important trade blocks include: EU, NAFTA, ASEAN, and SAARC.

(B) EUROPEAN UNION (EU)

The origin of the European Union goes back to the European Coal and Steel Community (ECSC) which was formed with the then West Germany, France, Italy, Belgium, Netherlands and Luxembourg in 1952. The aim of the ECSC was to eliminate import duties and quotas on coal, iron ore, steel and scrap regarding the international trade among the member countries. The successful functioning of ECSC stimulated the member countries to extend this facility to all commodities by the Treaty of Rome in 1957. This Treaty gave birth to European Economic Community.

- The European Economic Community is also known as European Common Market. Originally six countries, *viz.,* France, Federal Republic of Germany, Italy, Belgium, Netherlands and Luxembourg formed into the European Economic Community (EEC) by the Treaty of Rome, 1957. It came into being on 1st January 1958. The number of member countries of the EEC increased from six to nine on January 1, 1973 as United Kingdom, Ireland and Denmark joined the community. Greece joined the EEC in 1981 and Portugal and Spain joined in 1984. Austria, Finland and Sweden joined the community on January 1, 1986. With the introduction of uniform monetary policy, common currency and fiscal policy among the member countries the EEC became European Union(EU). On May 1, 2004, 10 more countries *viz*., Cyprus, Czech Republic, Estonia, Greece, Hungary, Latvia, Lithuania, Malta, Slovakia, Slovenia, joined EU. Thus the membership of EU as on 30th April 2005 is 25.The requirements for joining the EU as members are *(i)* the country must be European country and *(ii)* it must be a democratic country.

Objectives

EU consists of three organisations, *viz.,* the European Coal and Steel Community (ECSC), the European Economic Community (EEC) and the European Atomic Energy Community (Euratom). ECSC functions for 50 years and the EEC and Euratom function for an unlimited time duration.

The main objective of the EEC according to Article 2 of the Rome Treaty of 1957 is:

"The community shall have its task, by setting up a common market, to promote throughout the community a harmonious development by economic activities, a continuous and balanced expansion, an increase in stability and accelerated raising of the standard of living and closer relations between the Member States belonging to it."

Exhibit 7.1 presents the developments of the European Union in a chronological order.

EXHIBIT 7.1 DEVELOPMENTS OF THE EUROPEAN UNION IN A CHRONOLOGICAL ORDER

1952	Six countries - Belgium, France, the Federal Republic of Germany, Italy, Luxembourg and the Netherlands - create the European Coal and Steel Community (ECSC) by pooling their coal and steel resources in a common market controlled by an independent supranational authority.
1958	The Rome Treaties set up the European Economic Community (EEC) and the European Atomic Energy Community (Euratom), extending the common market for coal and steel to all economic sectors in the member countries.
1965	The Merger Treaty is signed in Brussels on April 8. It provides for a Single Commission and a Single Council of the then three European Communities.
1967	The Merger Treaty enters into force on July 1.
1973	The United Kingdom, Ireland, and Denmark join the European Community (EC).
1979	The European Parliament is elected, for the first time, by direct universal suffrage and the European Monetary System (EMS) becomes operative.
1981	Greece becomes the 10th member state.
1985	The program to complete the Single Market by 1992 is launched.
1986	Spain and Portugal become the 11th and 12th member states.
1987	The Single European Act (SEA) introduces majority voting on Single Market legislation and increases the power of the European Parliament.
1989	The Madrid European Council launches the plan for achievement of Economic and Monetary Union (EMU).
1990	East and West Germany are reunited after the fall of the Berlin Wall.
1991	Two parallel inter-governmental conferences produce the Treaty on European Union (Maastricht) which EU leaders approve at the Maastricht European Council.
1992	Treaty on European Union signed in Maastricht and sent to member states for ratification. First referendum in Denmark rejects the Treaty.
1993	The Single Market enters into force on January 1. In May, a second Danish referendum ratifies the Maastricht Treaty, which takes effect in November.
1994	The EU and the 7-member European Free Trade Association (EFTA) form the European Economic Area, a single market of 19 countries. The EU completes membership negotiations with EFTA members Austria, Finland, Norway and Sweden.
1995	Austria, Finland and Sweden join the EU on January 1. Norway fails to ratify its accession treaty. The EU prepares the 1996 Inter-governmental Conference on institutional reform.
1997	The **Treaty of Amsterdam**, resulting from the 1996 Inter-governmental Conference, is signed on October 2.
1999	The **Euro** is introduced on January 1 electronically in 12 participating member states, with complete introduction to occur in 2002. The **Amsterdam Treaty** enters into force on May 1.
2001	The **Treaty of Nice** results from the **2000 Inter-governmental Conference**.

2002	The **Euro** is fully launched on January 1. The **European Convention** begins, as part of the **debate on the future of Europe**, to propose a new framework and structures for the European Union—geared to changes in the world situation, the needs of the citizens of Europe and the future development of the European Union. On October 9, the European Commission recommends that candidate countries Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia be the first to join the EU under the latest enlargement process, possibly in time for the elections to the European Parliament scheduled for June 2004.
2003	The **Treaty of Nice** enters into force on February 1.
2004	**Ten countries** (Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia) join the European Union on May 1. (Bulgarian and Romanian accession are anticipated for 2007. At the summit on December 16 and 17, the European Council decides whether Turkey is ready to begin accession negotiations. On June 18, the European Council accepted Croatia as a candidate country. On March 22, the Former Yugoslav Republic of Macedonia [FYROM] applied for EU membership.) A new **European Parliament** is elected on June 10 to 13. A new **European Commission** takes office on November 22.
2005	France and Netherlands voted against EU constitution. Tony Blair argues for a fresh constitution.
2007	Bulgaria and Romania joined EU on January 1,2007. The membership of EU increased to 27 as on 31 st Jauary 2008.
2008	Provided humanitarian aid of Eur 5.5 million to Kenyan Post-election victims.

Source : Adapted from European Union, Website

Activities of the European Union

The activities of the EEC based on the objectives are:

- Elimination of customs duties, quantitative restrictions with regard to exports and imports of goods among member countries.
- Establishment/formulation of a common customs tariff and common commercial policy with regard to non-member countries.
- Abolition of all obstacles for movement of persons, services and capital among member countries.
- Formulation of common policy in the area of agriculture.
- Formulation of a common policy in the area of transport.
- Establishment of a system which would ensure competition among member countries.
- Application of programmes in order to coordinate the economic policies of the member countries.
- Application of the procedures and programmes to control the disequilibrium in the balance of payments of member countries.
- Approximation of legislation of the member governments to the extent required for the proper functioning of the common market.
- Establishment of European Social Fund with a view to enhance the employment opportunities for workers and to improve their living standards.

- Establishment of European Investment Bank for mobilisation of fresh resources and to contribute to the economic development of the community.
- Development of association with foreign countries to promote jointly the economic and social development of the EU.

Organisation of EU

European Council is the main administrative body of the EU. Each member country is represented by a minister in this council. Each member country holds the presidency of the council for six-monthly period by rotation. A committee of permanent representatives acts as the Secretariat of the council. This committee is also called, "Corper." The Corper makes all-important decisions. The Corper is the link between the EU and member Governments. *(See Figure 7.1).*

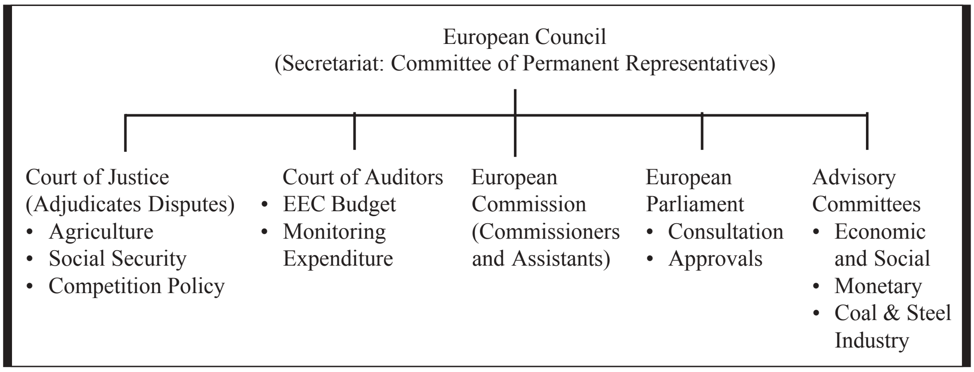

Fig. 7.1 : Organisation structure of the European Economic Community

European Council

European Council acts as the executive agent of the EU in:

- Making routine decisions.
- Formulating rules of conduct.
- Preparing new legislations.
- Enabling members to carry out the provisions of the Treaty.
- **European Commission:** The European Commission assists the Council. This is the executive body of the EU. The members of this commission are appointed for a period of four years which can be renewed. One or more EU policies are entrusted to each commissioner. Each commissioner is assisted by a chief of cabinet of his country. These assistants take decisions on behalf of their commissioners.
- **Court of Justice:** There is a court of justice to adjudicate disputes relating to agriculture, social security for migrants among the member countries and competition policy. The court also adjudicates disputes between the member countries brought by the commission against the council or commission reported by a person or a company.

- **Court of Auditors:** Court of auditors was appointed as a part of the EU by amending the Treaty of Rome. The activities of the court of auditors include:
  - Auditing the EEC budget.
  - Monitoring the EEC's expenditure.
  - Laying down improved procedures for collection of duties and levies.
- **European Parliament:** The European Commission should consult the Parliament before a final decision is taken. The Parliament acts through the Parliamentary Committee. The activities of the European Parliament include:
  - Provide consultations and information to the Commission.
  - Approve or reject the draft budget prepared by the Commission.
  - Dismiss the Commission, if necessary.

- **Advisory Committees:** There are several advisory committees to advise the European Commission. These committees include:
  - Economic and Social Committee.
  - Monetary Committee.
  - Consultative Committee on Coal and Steel Industry.
- **Economic and Social Committee:** This committee represents the activities like employers, employee unions, farmers, retail traders, liberal professions and public. European Commission appoints the members on this committee.
- **Monetary Committee:** This committee examines the monetary problems, problems of the balance of payments and suggests measures to overcome them.
- **Consultative Committee on Coal and Steel Industry:** This committee studies the problems of coal and steel industries and offers suggestions.

It would be appropriate for us to discuss the functioning of EU, having studied its organisation.

Functioning of the EU

Complete customs union became reality among the member countries of the EU by July 1, 1968. We study the functioning of the EU under the following aspects: Common agricultural policy, Common fisheries policy, European Monetary Union, Factor mobility, Regional development policy, and Common transport policy.

Different member countries of the EU were following different agricultural policies before the formation of EU. *For example,* the then West Germany and Italy fixed high support prices due to the inefficiency of their agricultural sector. The *vice versa* was true in case of France and Netherlands. The treaty favoured a common agricultural policy.

Common Agricultural Policy (CAP)

Under the common agricultural policy, there is a *'Green Rate'* for each country and the support price is converted into the national price at the green rate. Farmers are free to produce as much as they can.

- Agricultural products are free to move from one member country to other member countries.
- Imports are allowed only when the demand for a product is more than its supply. Variable import levy is used to offset any price advantage to the importers.
- If the community supply is more than the demand, subsidies are allowed to export or to encourage additional consumption among the member countries.
- EEC reformed its CAP by introducing 'cuts' in subsidies in July 1992 with a view to make its agriculture more competitive globally.
- EEC has achieved self-sufficiency in agriculture.
- Some of the farmers of the member countries have become unemployed and the EU could not motivate them to seek alternative employment.
- The reforms enabled the rich farmers to become richer, but the poor farmers incurred losses.
- Since the support prices are set at higher levels, consumers are deprived of the benefit of lower prices.
- The policy led to the surplus production of certain products like milk lakes, wine lakes and butter and beef mountains.

Common Fisheries Policy

EEC member countries agreed for a common fisheries policy in October 1970. This policy came into force in February 1971. Features of this policy include:

- Market for fresh frozen and preserved fish.
- Common market standards and facilities for trading among members.
- Equal access to fishing areas to all the nationals of the EU countries.

This policy failed in the reality as it was based on *ad hoc* compromises and concessions to member countries.

European Monetary Union

European Monetary Union was started in March 1979 with the following features:

- **Exchange Rate Mechanism (ERM):** Exchange Rate Mechanism helps the member countries to regulate inflation and interest rates. The member countries work to prevent wide shifts in the value of their currencies.
- **European Currency Unit:** European Currency Unit is the means for settlements between the central banks of the member countries. The

European currency unit is the weighted basket of all the currencies of member countries. The official rate of the ECU is calculated on 'daily-basis.'

- **European Monetary Co-operation Fund:** European Monetary Co-operation Fund acts as the 'clearing house' of the central banks of the member countries.
- **Factor Mobility:** One of the objectives of EU is to allow free movement of persons, services and capital among the member countries. The formal restrictions on the movement of labour were abolished by July 1968. Now the workers and their family members can move freely from one member country to the another without any permit. They have similar rights and obligations as the nationals have like right to work, social security and taxation. But the EU could not achieve its objectives with regard to capital mobility as it is hindered by the international monetary disturbances.
- **Regional Development Policy:** The objective of the regional development policy of the EU is to promote balanced development of the member countries by reducing regional disparities and by developing rapidly the backward regions. To achieve this objective, the EU provides financial assistance for the development of the backward regions of the member countries. The financial assistance is provided through.
- **European Investment Bank:** This bank was established in 1958 by EU. It provides loans and guarantees for the loans raised by the member countries for the development of backward regions. It grants loans for modernisation, conversion and development projects which are beyond the financial abilities of the member governments. It also provides loans for the projects in which member governments have common interest.
- **European Social Fund:** Some of the workers lost jobs due to the EU policies. Such workers are assisted to get employment by the European social fund. The financial assistance is meant for vocational training, job creation, income maintenance and anti-poverty programmes.
- **European Regional Development Fund:** This fund was established in 1958. It provides loans for the backward areas development of the EU. It also grants loans for the development of industrial service and infrastructure.[1]

Common Transport Policy

The objectives of the policy are:

- Removal of obstacles for having a common transport policy with a view to have common market place.
- Integration of transport facilities of the entire community.
- Organisation and control of the transport system within the community.

The EEC could not achieve these objectives completely due to the issues involved in infrastructure pricing, entry controls for the transportation goods by rail and road.

One Market: The EU has emerged as one market from January 1, 1995. The political national boundaries are erased for the business and economic activities — goods, services, people and capital can move freely from one country to another of the EU. Now, the member countries do not impose any import tariffs. Import tariffs of the member countries are replaced by the community tariffs system. This factor provides easy access of total EU to the exporters.

Retrospect: Thus, the EU could create the largest, single market by removing the obstacles for the free movement of goods, services, persons and capital among the member countries of the EEC. The single market enlarged the production, trade, income, investment and employment in all the member countries.

The balance of payments position of all the member counties has become strong. However, formation and successful functioning of EEC created a trade block for the emergence of the frontier free global trade.

EURO Currency : From 1st January 2002

History: The European Union (EU) was the outcome of the Treaty of Rome (1957). The Treaty of Rome declared a common European Market as a European objective with the aims of increasing economic prosperity and contributing to, "an ever closer Union among the peoples of Europe". This objective was the basis for enacting the single European Act in 1986 and for building up of Treaty on European Union in 1992. These two acts, contributed for the introduction of Economic and Monetary Union (EMU) and laying the foundations for "single currency".

The next stage began on 1st January 1999 when exchange rates of the participating currencies were irrevocably set. This led to the implementation of a Common Monetary Policy, and Euro as a legal currency. The eleven currencies of participants member countries became subdivisions of the Euro. The Euro had been an accounting unit used for electronic and credit card transactions since January 1999. Greece joined on 1st January 2001. Therefore, the 12 member countries introduced the new Euro bank notes and coins from 1 January 2002.

Euro Currency

Since 1 January 2002 when the Euro banknotes and coins were introduced, the single currency originates in all the treaties prepared and signed by the members of the European Council. The elected Governments of member states together created and developed the 'Euro'. The European Council adopted the name 'Euro' in December 1995 in Madrid.

Twelve member countries of the European Union participating in the Common currency. are: Belgium, Germany, Greece, Spain, France, Ireland, Italy, Luxembourg, The Netherlands, Austria, Portugal and Finland.

Denmark, Sweden and United Kingdom are members of the European Union but are not currently participating in the single currency.

These members introduced the single currency *i.e.,* Euro from 1 January 2002. Euro banknotes and coins arrived for residents of 12 European nations that were at war with each other 56 years ago. The 50 billion coins and 15 billion banknotes replaced national currencies for 300 million residents of the euro countries.

Purpose: The successful development of the Euro is central to the realization of a Europe in which people, services, capital and goods can more freely. Its purpose is to create a unified market and eliminate currency risk. Euro members hope to become more competitive and encourage trade, travel and investment. Political leaders of the member countries hope that Euro would eliminate inflation and currency crisis of the past.

The European System of Central Bank

The European Central Bank was established on 1 January 1998 in order to maintain price stability and conduct a single monetary policy across the Euro area. The national central banks of the European Union along with the European Central Bank make up the European System of the Central Bank.

The national central banks of Governments not participating in the Euro area *i.e.,* Denmark, Sweden and the United Kingdom, have a special status, which allows them to conduct their own national monetary policies, but not to take part in deciding and implementing monetary policy of the Euro area.

The Euro System

The national central banks of the euro area together with the European Central Bank are known as the Euro system. The Euro system's primary objective is the maintenance of price stability. It meets its objectives through:

- Deciding and implementing monetary policy,
- Conducting foreign exchange operations, and
- Operating payment system.

The National Central Banks of the participating Member States played a key role in the smooth transition to the euro. Their responsibilities include:

- Introducing the euro in their respective countries,
- Managing the changeover from national currencies to the euro,
- Creating the necessary systems to effectively circulate the euro banknotes and coins,
- Withdrawing national currencies, and
- Providing advice about and promoting the use of the euro.

Enlarged EU Mulls Future Challenge

The President of the European Commission, described the enlarged anniversary as "a forceful reminder that openness towards others - and not isolationism - is what drives the European Union and yields results. EU enlargement, had helped consolidate political and economic stability, democracy and human rights, and had strengthened the EU's international position. But he admitted it had also prompted questions about the EU's identity, its borders and how it should function in the future. Six of the 10 newcomers have already taken decisive steps towards adopting the euro as their currency in the next few years.

Politically, the newcomers have firmed up the EU's stance towards Russia and championed democratic changes in Ukraine and other parts of the former Soviet empire. Poland and Lithuania want the EU to go further, by offering Ukraine a clear prospect of membership. However, few Western Europeans share their appetite for more expansion. One year since the "Big Bang", the EU is suffering from what some call "enlargement blues". *(See Box 7.1)*

BOX 7.1 THE FUTURE OF THE EUROPEAN UNION

The most likely scenario for the future of the EU over the next decade and a half will be slow but steady progress towards integration, held back by the rich diversity of cultures and economic situations. A Greater Europe cannot be built without strong EU governance and visionary leadership, yet these are the two issues which are notably missing at present.

The European model is changing forever with rapid expansion to the East, doubling the number of countries and embracing nations that are extremely poor in comparison. Governance will be complex and so will be the culture mix. Culture differences are profound and deeply sensitive. Take language for example. In France there is great resentment about the dominance of the English language and it is illegal to play too many English songs on the radio. It is hard to imagine such a profound division between different States of America.

Bosnia, and Kosovo are both part of old Yugoslavia, yet another part of the same old nation is entering the EU: Slovenia. So here we have nations rushing to become one, who cannot even stop people in the same street butchering each other because they want to be so different. So expect growth, extension, vast economic trading areas, and with it growing tensions, xenophobia and resentment.

Source: Adapted from http://www.globalchange.com

Further expansion, especially to Turkey, but also to Croatia and other Balkan nations, could take much longer than expected. The accession of Bulgaria and Romania, planned for 2007, could also be delayed by a year. But both countries hold an insurance policy - they signed an accession treaty - so they are virtually certain of joining the block regardless of what happens to the European Constitution. Once they do, though, the EU may close its door for years to come.

EU Constitution

The constitution brings together for the first time the many treaties and agreements on which the EU is based. It defines the powers of the EU, stating where it can act and where the member states retain their right of veto. It also defines the role of the EU institutions. The EU constitution provides details in the following areas. France and Netherlands voted against constitution and as such the future of the EU constitution is at stake.

Powers of the EU	Foreign and defence policy
Division of responsibilities	Reform of the Commission
Decision-making	European Parliament
Qualified majority voting	Fundamental Rights
President	Legal Supremacy
Foreign Ministers	Leaving the EU

Now, we shall discuss another important trade block, *i.e.,* The North American Free Trade Agreement.

(C) NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA)

The North American Free Trade Agreement (NAFTA) came into being on January 1, 1994. The most affluent nations of the world, *i.e.,* the USA and Canada along with Mexico – a developing country joined together to form a trade block. A free trade agreement was signed by the USA and Canada in 1989. This was extended to Mexico in 1994. NAFTA is expected to eliminate all tariffs and trade barriers among these countries by 2009. However, internal tariffs on a large number of product categories were removed already.

NAFTA has a population of 363 million and hence it is one of the significant trading areas in the globe.

Objectives

The objectives of the NAFTA include :

- To create new business opportunities particularly in Mexico.
- To enhance the competitive advantage of the companies operating in the USA, Canada and Mexico in wider international markets.
- To reduce the prices of the products and services by enhancing the competition.
- To enhance industrial development and thereby employment throughout the region.
- To provide stable and predictable political environment for the investors.
- To develop industries in Mexico in order to create employment and to reduce migration from Mexico to the USA.
- To assist Mexico in earning additional foreign exchange to meet its foreign debt burden.
- To improve and consolidate political relationship among member countries.

Measures

The measures as per the agreement of NAFTA include:

- Opening up of Government procurement markets in each member country of NAFTA.

- Residents of NAFTA countries can invest in any other NAFTA countries freely.
- Protection of intellectual property rights of the NAFTA member countries.
- Simplification and harmonisation of product standards in all the member countries of NAFTA.
- Free flow of employees and business people from one member country to another. Prevention of non-Mexican firms assembling goods in Mexico.
- Avoidance of re-export of the products imported by any member country from the third party. This condition is not applicable, in case certain percentage of manufacturing costs are incurred in the importing country. This percentage is 50 in case of the USA and Canada and 80 in case of Mexico.
- Pollution control along the USA-Mexico border.

Critical Appraisal

It was felt that the emergence of NAFTA enables further development of the USA and Canada and for the significant development of Mexico. Further, the free flow of capital and human resources enables achieving equilibrium in the regional development.

From the U.S. and Canadian government's point of view, NAFTA was an opportunity to respond to the growing threat of the large European Union trading block. From the Mexican government’s point of view, the agreement was a way to secure future foreign investment.

A number of companies in the automotive industry, large agribusiness, telecommunications, high technology manufacturing, and big grain import industries have benefited from NAFTA. However, twelve years after it went into effect, a variety of research efforts have found that NAFTA has not lived up to the promises of its backers. Despite its mixed results, free traders continue to try and sell a “successful” NAFTA and present it as a model and minimum baseline for other U.S. trade agreements.

A Look at NAFTA Beyond the Surface

NAFTA is not responsible for all of the economic and social ills in North America. But in Mexico, it has caused an acceleration and locking-in of policies that had already failed to bring prosperity. An evaluation of NAFTA’s results is essential as the U.S. seeks to negotiate new NAFTA-style agreements at a record pace.

Impacts in the United States

- The trade surplus (exports exceed imports) with Mexico before NAFTA has turned into a massive trade deficit (imports exceed exports), which has eliminated 1,015,291 U.S. jobs since NAFTA took effect in 1994. Most displaced workers find jobs in other sectors, such as in the service industry, where wages are much lower.

- Because the U.S. tends to import goods produced by lower-skilled workers, increased openness to trade has forced employers to compete by reducing the wages of lower-skilled workers relative to other workers in the U.S.
- U.S. workers feel more insecure about their economic future as both wages and union activity are increasingly constrained by threats from employers to move overseas.

Impacts in Mexico

Since 1994, foreign investment in Mexico has boomed, exports to the U.S. have surged, and employment in the export-oriented manufacturing companies known as maquiladoras has doubled. But a closer look shows a not-so-rosy reality.

- Half the foreign direct investment under NAFTA has been concentrated in the maquiladoras-the overwhelming majority of which are U.S.-owned.
- Although Mexico's exports have been significant, nearly all of the components of those exports are imported goods. For decades, the domestic input of components and packaging in the maquiladora industry has been less than 3 percent, limiting the development of secondary industries in Mexico that would create more jobs and reduce the number of imports needed.
- Although Mexico's trade deficit with the U.S. has dropped since 1994, the country carries a growing trade deficit with Asia and Europe, which increased by 600 percent and 400 percent respectively.
- Between 1994 and 2003 an estimated 9.3 million people entered the labor force, while only three million jobs were created, forcing people to scrape together informal work or migrate North.
- Growth has slowed to 1 percent on a per capita basis (from 3.2 percent during 1948-73), income disparities between the U.S. and Mexico have grown by 10.6 percent, and real wages have been falling at a rate of 0.2 percent a year.
- The agricultural sector has been decimated by the 240% increase in imports of subsidized U.S. corn , causing the price of corn to drop more than 70% which displaced an estimated 1.7 million farmers .
- In 1990, there were 2 million undocumented Mexicans working in the U.S., by 2004, there were 6 million.

A Threat to National Sovereignty

One of the most controversial and troubling aspects of NAFTA is the "investor rights" clause, or Chapter 11, which permits NAFTA governments to be sued directly by foreign investors who claim future profits were interrupted by public-interest laws. Three examples of cases under NAFTA's Chapter 11 are listed below. All were tried before secret ad-hoc international tribunals.

- When California banned a gasoline additive called MTBE that had contaminated drinking water throughout the state, the Canadian Methanex

Corporation sued the U.S. government to force citizens to pay nearly one billion dollars for its potential lost profits .

- U.S.-based Ethyl Corporation forced Canada to pay $13 million in damages and drop its ban on the dangerous gasoline additive MMT, a known toxin that attacks the human nervous system.
- U.S.-based Metalclad Corporation successfully sued a Mexican state to allow a toxic waste disposal site, claiming that the environmental zoning law forbidding the dump constituted an effective seizure of the company's property. *(See Box 7.2)*

BOX 7.2 **THE FUTURE OF NAFTA**

The U.S. Treasury Office is not only determined to replicate and expand the NAFTA model (see CAFTA and U.S.-Colombia FTA) but also to renegotiate NAFTA itself. Since March of 2005 the three NAFTA heads of state have been meeting in secret under what they call the Security and Prosperity Partnership (SPP) of North America. Negotiated under the U.S. Department of Homeland Security, the idea is to make entry into Canada and Mexico as rigorous as it is in the U.S. while assuring the continued flow of goods across the two borders—melding trade and security policy priorities.

Consistent with other trade agreements, the SPP is a process outside of Legislative oversight. Left to the Executive branch, it is being developed with considerable input from multinational corporations.

Source: www.nafta.org

(D) THE ASSOCIATION OF SOUTH-EAST ASIAN NATIONS (ASEAN)

A group of six countries, *viz.,* Singapore, Brunei, Malaysia, Philippines, Thailand and Indonesia, agreed in January 1992 to establish a Common Effective Preferential Tariffs (CEPT) plan. This plan helped to create an Association of South-East Asian Nations (ASEAN) free trade area in 15 years with effect from January 1993. The CEPT allows for tariffs cut ranging from 0.50 per cent to 20 per cent beginning with 15 products. *Table 7.1* shows the trade ratios for ASEAN.

The emergence and successful operation of EEC and NAFTA gave impetus for the forming of ASEAN. The ASEAN member countries have developed economically at a fast rate in the globe. Their strength lies is well educated and skilled human resources. This strength enabled them to achieve faster industrialisation. Further the ASEAN member countries are rich in oil, mineral resources, agricultural goods and modern industrial products. These countries invite and allow the free-flow of foreign capital.

The formation of ASEAN enabled the member countries to have close cohesiveness, share their economic and human resources and achieve synergy in the development of their agricultural sectors, industrial sectors and service sectors. *Figure 7.2 presents the ASEAN organisational structure.*

TABLE 7.1 TRADE RATIOS FOR ASEAN, 1970-2006

Country	*1970*	*1980*	*1990*	*2000*	*2006*
Indonesia	0.25	0.50	0.55	0.58	0.62
Malaysia	0.74	0.86	1.43	1.56	1.68
Philippines	0.33	0.38	0.55	0.65	0.78
Singapore	1.95	3.66	2.90	3.18	4.14
Thailand	0.31	0.45	0.61	0.71	0.81
Vietnam	n.a	n.a.	n.a.	0.51	0.64

[a] The sum of merchandise exports (F.O.B.) and merchandise imports (c.i.f.) as a ratio of GNP (all in current U.S. dollars).
[b] Except Brunei. [c] The GNP is that of 1989.
[d] As a ratio of GDP. [e] The figure is for 1993.
n.a. = Not available.

Source : Asian Development Bank, Key Indicators of Developing Member Countries *(various issues).*

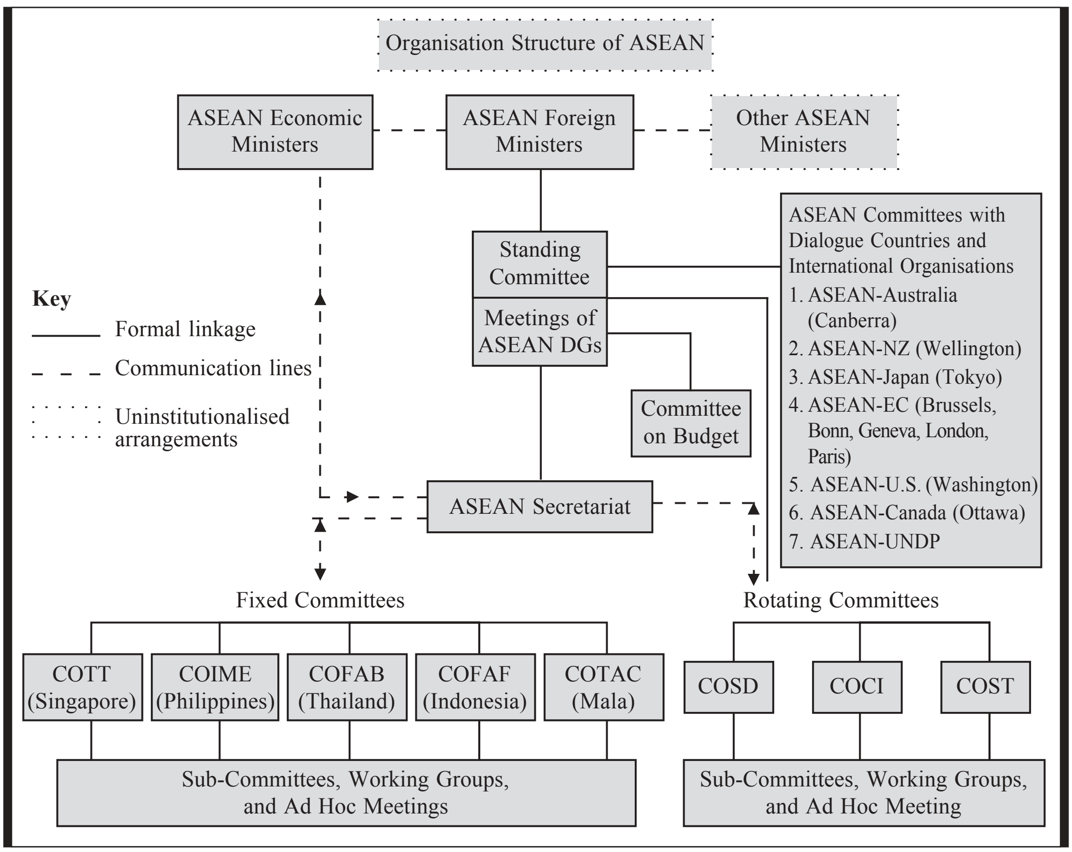

Fig. 7.2 : Organisational Structure of ASEAN

Source: Asean Economic Co-operation, Transition and Transformation, ISEAS, 1997, p.25.

The charts relating to subsidiary Bodies of the ASEAN Committees, the Machinery of ASEAN Economic Co-operation and New organisational structure of ASEAN.

The common historical and cultural background made the member countries to maintain their unity and solidarity by establishing a trade block. ASEAN countries have the determination to develop south-east Asia a nuclear weapons free area and a zone of peace, freedom and neutrality.

Asean Free Trade Area (AFTA)

The ASEAN countries are vigilant of the developments in the international environment like the formation NAFTA, SAARC and the introduction of Euro. In view of these developments, the ASEAN countries formed the Asean Free Trade Area (AFTA) in September 1994. The AFTA initially set to function for 10 years in order to develop inter ASEAN trade.

The Objectives of the AFTA are:

- to encourage inflow of foreign investment into this region.
- to establish free trade area in the member countries.
- to reduce tariff of the products produced in ASEAN countries. 40% value addition in the ASEAN countries to the product value is treated as manufactured in ASEAN countries.

AFTA and India

India would like to associate itself with ASEAN in order to develop trade relation and gain the benefits from AFTA.

India-ASEAN relations, as they exist today, are in some ways, a reconfiguration of age-old ties that date back 2,000 years. Only the modes of trade have changed. Instead of the silk route, countries now use tech-oriented routes to link up.

For a relationship that began warming up only about a decade ago, the India-ASEAN partnership has been trotting at quite a fast pace.

- India became a sectoral dialogue partner of ASEAN in 1992. The sectors were trade, investment, tourism and science and technology.
- Mutual interest led ASEAN to invite India to become a full dialogue partner of ASEAN during the fifth ASEAN summit in Bangkok in 1995 and a member of the ASEAN Regional Forum (ARF) in 1996.
- India has entered into an agreement with Thailand for a free trade area (FTA). This was followed with a similar agreement with Singapore in a Comprehensive Economic Cooperation Agreement (CECA).
- Sub-regional cooperation has accelerated too. The Mekong-Ganga Cooperation (MGC) and the BIMST-EC (Bangladesh, India, Myanmar, Sri Lanka, Thailand Economic Cooperation) are indicators to this effect.

The deepening of ties is beginning to show in the intra-country trade figures. India's trade with ASEAN countries rose from US$ 9.7 thousand million in

2002-2003 to more than US$ 30.64 billion in 2006-07. According to the Directorate General of Commercial Intelligence and Statistics (DGCIS), Kolkata, India's exports to ASEAN countries increased from US$ 10.41 billion in 2005-06 to US$ 12.56 billion in 2006-07, registering a growth of 20.67 per cent. India's imports from ASEAN countries increased from US$ 10.88 billion in 2005-06 to US$ 18.08 billion in 2006-07, registering a growth of over 66 per cent. ASEAN accounted for 9.49 per cent of India's imports and 9.95 per cent of India's exports during 2006-07. This figure is likely to grow further after the Free Trade Agreement (FTA) between India and ASEAN gets through in May 2008. *(See Box 7.3)*

BOX 7.3 THE 6TH INDIA-ASEAN SUMMIT

The 6th India-ASEAN summit in Singapore in November 2007, India proposed to enhance bilateral trade with the ASEAN countries from the current US$ 30 billion turnover to a target of US$ 50 billion by 2010. It also proposed:

- A US$ 1 million fund for an India-ASEAN Science and Technology Fund. This fund would be used for collaborative research and development.
- A joint network on climate change for which India has made an initial contribution of US$ 5 million to set up an India-ASEAN Green Fund.
- Joint production of medical formulations and for co-operation in traditional medicine systems that are popular in Asean as well as in India.
- Working on a target of one million tourists to India from Asean countries by 2010, the year New Delhi will host the Commonwealth Games. More than two million tourists from India travelled to ASEAN travel destinations this year in comparison to 280,000 ASEAN tourists who travelled to India.

At this point, India is poised at a strategic moment from where it can pitch for better cooperation with the ASEAN countries. Its economy fared rather well in fiscal 2006-07 with a GDP growth of 9.2 per cent, making it one of the fastest growing economies in the world. Its forex reserves now stand at an enviable US$ 273 billion.

Source: Adapted from www.asean.org

(E) EUROPEAN FREE TRADE ASSOCIATION (EFTA)

The European Free Trade Association (EFTA) was formed in 1959. The member countries of EFTA include: Austria, Norway, Portugal, Sweden and Switzerland. The associate member countries are: Finland and Iceland, Great Britain and Denmark.

Objectives

The Objectives of EFTA are:

- to eliminate almost all tariffs among member countries.

- to abolish the trade restrictions regarding imports and exports of goods among member countries.
- to enhance economic development, employment, incomes and living standards of the people of the member countries.
- to enable free trade in Western Europe.

The EFTA achieved most of its objectives during its 40 years of existence. EFTA does not regulate the agriculture and economy of the member countries and members' trade outside the EFTA. The EFTA is managed by a council. Each member country is represented by its representative to the EFTA council. The EFTA Council makes policy decisions of the organisation. Secretary-General implements the policies.

(F) LATIN AMERICAN INTEGRATION ASSOCIATION (LAIA)

Latin American Free Trade Association (LAFTA) on the lines of EFTA was formed in 1960. The countries signed the LAFTA agreement were Argentina, Brazil, Chile, Mexico, Paraguay, Peru, Uruguay, Colombia, Ecuador, Venezuela and Bolivia. Later the Latin American Integration Association (LAIA) replaced LAFTA.

Objectives

The objectives of LAIA are:

- to eliminate restrictions on trade among the member countries, and
- to reduce the customs and tariffs and eliminate them gradually.

Organisation Structure

LAIA is managed by a Council of Ministers. Foreign Ministers of the member countries represent their respective countries in the council. The Council of Ministers is assisted by a conference of contracting parties which makes decisions on issues requiring a joint resolution of the members and a permanent Executive Committee. Executive Committee Implements the treaty. The Executive Committee is assisted by a secretariat. *(See Figure 7.3).*

Council of Ministers
(Foreign Ministers of Member Countries)
↓
Conference of Contracting Parties
(Makes Decisions on Joint Issues)
↓
Executive Committee
(Supervises the Implementation of the Treaty)
↓
Secretariat
(Performs Technical and Administrative Functions)

Fig. 7.3 : Organisation Structure of Latin American Integration Association (LAIA)

Operations: Members prepare a list of goods on which they consider duty reductions. Member countries negotiate once in three years for complete exemption of tariffs and decide the list of products eligible for complete exemption of tariffs. In fact, they include all the products which are traded in the region in the list. More favourable terms are granted for the less developed countries of the region.

Critical Appraisal: The performance of the LAIA is only modest. The reasons for modest performance include:

- Delay and negative approach of the members in preparing common list.
- High cost of transportation.
- Contentment of the members with the sheltered markets.
- Forces of nationalism.

Now, we shall discuss another important trade block, *i.e.,* South Asian Association for Regional Co-operation (SAARC).

(G) SOUTH ASIAN ASSOCIATION FOR REGIONAL CO-OPERATION (SAARC)

The successful performance of EEC, NAFTA and other trade blocks in the economic development of the member countries and in improving the employment opportunities, incomes and living standards of the people of the region gave impetus for the formation of South Asian Association for Regional Co-operation (SAARC).

India, Bangladesh, Bhutan, Pakistan, the Maldives Nepal and Sri Lanka established SAARC on December 8,1985.Afghanistan joined SAARC in April 2007.

Objectives

The objectives of the SAARC are:

- to improve the quality of life and welfare of the people of the SAARC member countries.
- to develop the region economically, socially and culturally.
- to provide the opportunity to the people of the region to live in dignity and to exploit their potentialities.
- to enhance the self-reliance of the member countries jointly.
- to provide conducive climate for creating and enhancing mutual trust, understanding and application of one another’s issues.
- to enhance the mutual assistance among member countries in the areas of economic, social, cultural, scientific and technical fields.
- to enhance the co-operation with other developing economies.
- to have unity among the member countries regarding the issues of common interest in the international forums.
- to extend co-operation to other trade blocks.

Organisation Structure

The Council of the SAARC is the highest policy making body.

The Council is represented by the heads of the Government of the member countries.

The Council meets once in two years. This council is assisted by the 'Council of Ministers'.

The Council of Ministers is represented by the foreign ministers of member governments. It formulates policies, reviews the functioning and decides the new areas of co-operation, establishes additional mechanism, decides the issues of general interests to the SAARC member countries. The Council meets twice a year and more times, if necessary. The Council of Ministers is assisted by the standing committee.

Standing Committee consists of foreign secretaries of member governments. The functions of the standing committee include:

- Monitoring and co-ordinating the programmes.
- Determining inter-sectoral priorities.
- Mobilising co-operation within and outside the region.
- Formulating the modalities of financing.

Standing committee is expected to meet as and when necessary and submits the report to the Council of Ministers. This committee sets up action committee for the project implementation. The standing committee is assisted by the programming committee.

Programming committee includes the senior officials of the member governments. The functions of the programming committee are:

- Scrutinising the budget of the secretariat.
- Finalising the annual schedule of the secretariat.
- Carrying out the activities assigned by the standing committee.
- Analysing the reports of the technical committees and SAARC regional centres and submitting them to the standing committee along with its comments.

Technical committees comprise the representatives of all member countries. Their functions include:

- Formulating projects and programmes in their respective areas.
- Monitoring and implementing the projects.
- Submitting the reports to the standing committee through the programme committee.

The technical committees of the SAARC include:

- Agriculture
- Communications
- Environment
- Health and Population Activities

- Rural Development
- Science and Technology
- Tourism and Transport.

All the secretarial work is done by the *SAARC secretariat,* which is located in Nepal. The activities of the secretariat include:

- Co-ordinating, monitoring and implementing SAARC activities.
- Servicing the meetings of the SAARC.
- Serving as communication link between SAARC and other international forums.

The Secretary-General is the chief of the secretariat. He/she is appointed by the Council of Ministers on rotation basis among members for a period of three years. He is assisted by seven Directors (one from each member country) and general service staff. *(See Figure 7.4 for organisational structure of SAARC).*

The Council
Highest Policy-Making Body
↓
Council of Ministers
(Represented by the Foreign Ministers of the Member Governments)
Formulates Policies, Reviews the Functioning of SAARC
(Consists of Secretariat, Secretary-General, Directors and General Staff)
↓
Standing Committee
(Represented by Foreign Secretaries of the Member Governments)
Monitors and Co-ordinates the Programmes
↓
Programming Committee
(Represented by the Senior Officials of the Member Governments)
Scrutinises Budget and Annual Schedule
↓
Technical Committees
(Comprises the Representatives of All Countries)
Formulates, Implements and Monitors Projects

Fig.7.4 : Organisation Structure of SAARC

SAARC preferential Trading Arrangement (SAPTA)

The Council of Ministers have signed the SAARC Preferential Trading Arrangement agreement on April 11, 1993.

Objectives of SAPTA : The objectives of SAPTA are:

- To gradually liberalise the trade among member countries of SAARC.
- To eliminate trade barriers among SAARC countries and reduce or eliminate tariffs.

- To promote and sustain mutual trade and economic co-operation among member countries.

Administration of SAPTA: SAARC Preferential Trading Arrangement agreement would be administered on the following lines:

- The benefits to the member countries would be accorded on equitable basis of reciprocity and mutuality.
- The Agreement would be improved step by step through mutual negotiations.
- The Agreement has taken the special needs of the less developed countries into consideration.

Product Areas: All raw materials, semi-finished products and finished products are included for mutual concessions.

Tariffs: Concessions would be given in tariffs, para-tariffs, non-tariffs and trade measures. Special treatment for the least developed countries would be provided in the following ways:

- Providing technical assistance, establishment of industrial and agricultural projects in order to boost up their exports.
- Enhancing their exports by eliminating non-tariff and para-tariff barriers, providing duty free access, etc.
- Establishing training facilities in the areas of export trade.
- Providing export credit insurance and market information.
- Entering into long-term contracts.

Balance of Payments

If the concessions enhance the imports resulting in serious balance of payments problem, the importing country can suspend the concessions.

- Provisions for information, consultation and dispute settlement are provided.
- ***Extension of concessions:*** The concessions would be extended to all member countries (expect those meant for least developed countries).
- ***Committee of participants:*** Committee of participants would review the implementation of this agreement and distribution of the benefits among member countries equitably.
- ***Non-application of the provisions:*** If the benefits similar to those stated in the provisions of this agreement are already granted by one member country to another through any other arrangement, the provisions in this agreement are not applicable to the same case distribution of benefits among member countries equitably.
- ***Modification and withdrawal of concessions:*** Concessions provided under this agreement can be withdrawn or modified through the mutual consultations and agreement of the countries concerned after three years. However, Committee on Economic Co-operation (CEC) will monitor these aspects.

- ***Withdrawal from SAPTA:*** Member countries by giving six months' notice to SAARC Secretariat and committee on Economic Co-operation can withdraw from the SAPTA.

SAARC

It was hoped at the 13th South Asian Regional Association for Regional Co-operation (SAARC) summit held at on 12th and 13th November, 2005 in Dhaka for a consensus on the remaining issues to implement the South Asian Free Trade Agreement (SAFTA) from January 1, 2006, it is envisaged a region where people, investments and trade in goods and services would have unhindered mobility across national boundaries, opening up physical economic space for the well-being and prosperity of South Asians.

The 14 th SAARC summit was held during 3-4, April 2007 at New Delhi and the members agreed to root-out terrorism and turn around the under performing trading bloc. *(See Box 7.4)*

SAARC MEET ADOPTS PLAN TO ACTIVATE SAPTA

The SAARC Finance and Planning Ministers meet on 'poverty alleviation' has endorsed an action plan for full operationalisation of the South Asia Preferential Trade Agreement (SAPTA) and move faster towards the South Asia Free Trade Agreement. The plan enhances the potential for increased trade and commerce between India and Pakistan notwithstanding the ups and downs in their political ties.

India has accorded the Most Favoured Nation (MFN) status to Pakistan and has been urging Islamabad for reciprocity. The full operationalisation of SAPTA and a faster movement towards SAFTA will automatically open up markets for both India and Pakistan on a large number of commodities. At the moment, under its export-import policy, Pakistan permits import of only 600 and so items from India. Four rounds of negotiations have already been completed on SAFTA. The fourth round was held and it was decided to include in the basket items highly traded and potential items.

The Ministers have agreed to seek increased market access in developed countries through joint positions to address the biases against developing countries in WTO-related issues, removal of tariff and non-tariff barriers, joint positions against creeping protectionism against the exports of developing countries and flexibility for developing countries in Intellectual Property Rights.

Source: The Hindu, 11 April, 2002

Vision

"Our vision looks beyond regional cooperation in trade under SAFTA, towards a future of eventual economic integration in the region. This will include a mutually supportive process of strengthening the physical, legal and technical infrastructure and overall connectivity in the region," It is hoped that SAARC would become fully integrated into a future global architecture consisting of major trading blocs. An Asian economic community, which will include the SAARC region, for example, will constitute the largest consumer conglomerate in the world.

Disaster Mitigation

"Another important initiative that will be taken up at the summit will be ways and means of co-operating in the area of disaster preparedness and mitigation,

If the leaders endorse the proposal, the next SAARC summit, to be held in India, may grant Afghanistan the membership.

Future membership of SAARC

The People's Republic of China has shown its interest in joining SAARC.While Pakistan and Bangladesh support China's candidature, India is more reluctant about the prospect of Chinese membership, while Bhutan does not even have diplomatic relations with China. However, during the 2005 Dhaka summit, India agreed on granting observer status to the PRC along with Japan. During the 14th summit, Nepal announced its support for the membership of China.Pakistan, Bangladesh, and Nepal gave strong support for the membership of China.

The Islamic Republic of Iran, a state with borders to two SAARC members, has traditionally enjoyed strong cultural, economic and political relationship with Afghanistan, India and Pakistan and has expressed its desire to become a member of the South Asian organisation. On 22 February 2005, the Foreign Minister of Iran, Kamal Kharrazi, indicated Iran's interest in joining SAARC by saying that his country could provide the region with "East-West connectivity".On 3 March 2007, Iran asked to join the SAARC as an observer. SAARC Secretary-General Lyonpo Chenkyab Dorji responded by saying that Iran's request for observer status would be taken up during a meeting of ministers of foreign affairs of SAARC member countries.

POINTS TO BE REMEMBERED

- Economic integration among the world economies varies in degree. They are: free trade area, customs union, common market, and economic union.
- EEC has common agricultural policy, common transport policy, common fisheries policy, common monetary union, etc.
- NAFTA is expected to eliminate all tariffs and trade barriers among the USA, Canada and Mexico.
- SAARC has been trying for improving the quality of life and welfare of the people, develop the region economically and provide the opportunities to the people of the member countries.
- Globalisation implies opening up the economy for rest of the globe by liberalising the rules and regulations.

KEY WORDS

- Free Trade Area
- Common Market
- Economic Integration
- EURO
- SAARC
- Globalisation
- Multinational Corporation
- International Monetary Fund
- World Bank
- Foreign Institutional Investors
- Customs Union
- Economic Union
- European Union
- North American Free Trade Agreement
- Product Area
- WTO
- Multi-Fibre Agreement
- Ministerial Conference
- General Council
- Councils

QUESTIONS FOR DISCUSSION

1. What is economic integration? Explain the different kinds of economic integration.
2. What are the advantages and disadvantages of economic integration?
3. State the objectives of EEC. Explain the achievements of EU in integrating its member countries.
4. Describe the steps taken by NAFTA in bringing economic integration among the USA, Canada and Mexico.
5. What is globalisation? Explain the factors responsible for globalising the Indian economy.
6. Explain the steps towards globalisation.

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SKILL DEVELOPMENT

CHAPTER OUTLINE

I. List atleast 3 MNCs of G-7 Countries operating in India along with products they manufacture.
II. Preparation of a chart on different currencies of different countries.
III. Table of atleast one month data of Foreign exchange rate of atleast 2 currencies.
IV. Latest news affecting India through WTO, World Bank, IMF etc.
V. Chart of product life cycle of International product.
VI. Description of procedures followed in recruitment / selection of atleast one MNC in India.

I. LIST AT LEAST 3 MNCs OF G-7 COUNTRIES OPERATING IN INDIA ALONG WITH PRODUCTS THEY MANUFACTURE

G-7 Countries: Originally seven countries formed into group-7 (G-7) countries to deal with the major economic and political issues of their countries and international community. These countries include: USA, Canada, France, Germany, Italy, UK, and Japan. Russia joined this group and this group became G-8.

1. **Hindustan Lever Limited (HLL) :** Hindustan Lever Limited (HLL), a 51%-owned subsidiary of UK/Netherlands giant Unilever, which is partly G-7 MNC has been prying its way into India since 1888. India's largest consumer goods company, HHL markets products such as beverages, food, and home and personal care goods. Its brands include Kwality Wall's ice cream, Lifebuoy soap, Lipton tea, Pepsodent toothpaste, and Surf laundry detergent. HLL also markets atta (a type of meal), maize, rice, salt, and specialty chemicals, and its export division ships castor oil and fish. The company plans to begin selling bottled water and over-the-counter healthcare products.

   (*Source:* Adapted from: http://biz.yahoo.com/ic/57/57109.html)

2. **Coca-Cola India Limited :** The Coca-Cola Company is USA based MNC. Its beverages are produced locally, employing Indian citizens, our product range and marketing reflect Indian tastes and lifestyles, and we are deeply involved in the life of the local communities in which we operate.

Leading Indian brands include : Thums Up, Limca, Maaza, Citra and Gold Spot join the Company's international family of brands, including Coca-Cola, diet Coke, Sprite and Fanta, plus the Schweppes product range. It also produce mineral water under Kinley water brand, and powdered concentrate under Sunfill brand. (*Source:* http://www.myenjoyzone.com/press1/business.htm)

3. **The Xerox Corporation** was incorporated ion April 18, 1906. The corporation is highly multinational oriented and is divided into four major segments; Document processing, insurance, third-party financing, and finally investment banking

services. Xerox corporation operates in the Western hemisphere, while its subsidiaries, Rank Xerox Ltd., operates in Europe, and Fuji Xerox which is responsible for the corporation's operations in Pacific nations.

Leading Indian brands include: Photo Copying machines

4. **Sony** is a Japanese leading manufacturer of audio, video, communications, and information technology products for the consumer and professional market. Its music, motion picture, television, computer entertainment, and online businesses make Sony one of the most comprehensive entertainment companies in the world. Sony's principal U.S. businesses include Sony Electronics Inc., Sony Pictures Entertainment, Sony Computer Entertainment America Inc., and a 50% interest in Sony BMG Music Entertainment, the second-largest record company in the world.

Products and brands include:

- CLIÉ
- PlayStation
- MicroMV
- SonicStage
- HDV
- Qualia
- Blu-ray Disc
- PSX
- Qrio
- PlayStation Portable
- Universal Media Disc
- Librie
- LocationFree
- Cellular Walkman
- Bravia

II. PREPARATION OF A CHART ON DIFFERENT CURRENCIES OF DIFFERENT COUNTRIES (SELECTED)

Country	Currency
Afghanistan	Afghani
Albania	Lek
Algeria	Dinar
American Samoa	UD Dollar
Andorra	Euro
Angola	Kwanza
Argentina	Peso
Australia	Dollar
Austria	Euro/ Schilling
Bahamas	Dollar
Bahrain	Dinar
Bangladesh	Taka
Belgium	Euro/Franc
Bhutan	Indian Rupee
Botswana	Pula
Brazil	Real
Brunei	Dollar
Chile	Franc
China	Yuan Renminbi
Costa Rica	Colon
Cuba	Convertible Peso
Cyprus	Pound
Czech Republic	Koruna
Denmark	Krone
Egypt	Pound
Eritrea	Nakfa
Ethiopia	Birr
Fiji	Dollar
Finland	Euro/Markka
France	Franc/Euro
Germany	Euro/Deutsche Mark
Ghana	Cedi

Country	Currency
Greece	Euro/Drachma
Hong Kong	Dollar
Ice Land	Krona
India	Rupee
Indonesia	Rupiah
Iran	Rial
Iraq	Dinar
Ireland	Euro/Pound
Italy	Euro/Lira
Japan	Yen
Jordan	Dinar
Kazakhstan	Tenge
Kenya	Shilling
Kuwait	Dinar
Kyrgyzstan	Som
Lebanon	Pound
Libya	Dinar
Luxembourg	Euro/franc
Malaysia	Ringgit
Mexico	Peso
Morocco	Dirham
Mozambique	Metical
Myanmar	Kyat
Namibia	Dollar
Nepal	Rupee
Netherlands	Euro/Guilder
New Zealand	Dollar
Nigeria	Naira
North Korea	Won
Norway	Krone
Oman	Rial
Pakistan	Rupee
Papua New Guinea	Kina
Peru	Nuevo Sol
Philippines	Peso

Country	Currency
Poland	Zloty
Portugal	Euro/Escudo
Qatar	Riyal
Romania	Leu
Russia	Ruble
Rwanda	Fran
Saudi Arabia	Riyal
Singapore	Dollar
Solomon Islands	Dollar
South Africa	Rand
South Korea	Won
Spain	Euro/ Peseta
Sri Lanka	Rupee
Sudan	Dinar
Sweden	Krona
Switzerland	Franc
Syria	Pound
Taiwan	New Dollar
Tanzania	Shilling
Thailand	Baht
Turkey	New Lira
United Arab Emirates	Dirham
United Kingdom	Pound
United States of America	Dollar
Vanuatu	Vatu
Vatican City	Euro/Lira
Vietnam	Dong
Yemen	Riyal
Zambia	Kwacha
Zimbabwe	Dollar

III. TABLE OF AT LEAST ONE MONTH DATA OF FOREIGN EXCHANGE RATE OF AT LEAST 2 CURRENCIES

One Papua New Guinea's (PNG)Kina's Exchange Rate in terms of Indian Rupee and USA's Dollar

Date	1 PNG Kina = Indian Rupees	1 PNG Kina = USA Dollar
1 May 2008	13.5123	0.3510
2 May 2008	13.5234	0.3510
3 May 2008	13.6754	0.3512
4 May 2008	13.6754	0.3512
5 May 2008	13.7236	0.3515
6 May 2008	13. 8245	0.3518
7 May 2008	13.9765	0.3520
8 May 2008	14.2368	0.3521
9 May 2008	14.3456	0.3522
10 May 2008	14.4589	0.3524
11 May 2008	14.5468	0.3524
12 May 2008	14.6789	0.3525
13 May 2008	14.7654	0.3528
14 May 2008	14.6789	0.3529
15 May 2008	14.6789	0.3530
16 May 2008	14.7890	0.3530
17 May 2008	14.7890	0.3532
18 May 2008	14.8234	0.3532
19 May 2008	14.8234	0.3533
20 May 2008	14.8896	0.3534
21 May 2008	14.8456	0.3534
22 May 2008	14.8679	0.3535
23 May 2008	14.9234	0.3536
24 May 2008	14.9234	0.3538
25 May 2008	14.9245	0.3540
26 May 2008	14.6590	0.3552
27 May 2008	14.6590	0.3556
28 May 2008	14.9235	0.3564
29 May 2008	14.9245	0.3572
30 May 2008	14.9256	0.3572
31 May 2008	14.9256	0.3578

IV. LATEST NEWS AFFECTING INDIA THROUGH WORLD BANK, WTO, IMF ETC.

IMF and India: The 500 Billion Dollar Question

May 4, 2008

Today, few question the need for substantial improvement in India's infrastructure if the rapid growth is to be sustained. Recognizing this, the Planning Commission has put front and center in its strategy to sustain faster, more broad-based and inclusive growth, investment of about $500 billion in infrastructure before the end of the 11th Five Year Plan in March 2012.

Over the past three years, India has invested an average of 4½ percent of GDP each year in infrastructure. Getting to the Planning Commission's target-which is estimated to be the equivalent of 9 percent of GDP in 2011/12-means that infrastructure investment will need to increase by nearly 1 percent of GDP each year between 2007/08 and 20011/12 percent of GDP. The question we ask here is: where will the resources to finance this additional investment-nearly 5 percentage points of GDP by 2012-come from?

Let us look first at domestic sources. India's household sector saves about 24 percent of GDP up from around 16 percent of GDP only a decade ago. Over this same period, India's corporate sector's savings has also increased from around 4 percent of GDP to close to 8 percent. Can we expect such increases to continue? Perhaps but it is not likely. Household savings, are already at the high end of broadly comparable emerging markets. And corporate profitability-which has been remarkably high-is likely to be buffeted by the slowing global economy, the financial turmoil, and upward pressure on wages. Therefore, it may not be realistic to expect much by way of *additional* savings from India's private sector.

What about the public sector? From dissavings of around 1 percent of GDP a decade ago, public sector savings shot up to an impressive 3 percent of GDP in 2007/08. But given the pressures from the 6th Pay Commission, the agricultural loan waiver, and continued commodity subsidies it will likely be difficult to increase or even to maintain this level of savings in the absence of substantial improvements in tax revenue collection..

So, the 500 billion dollar question: Can India achieve the 11th Five Year Plan's target for infrastructure investment without foreign capital? We argue that it cannot.

In 2006/07, net capital inflows amounted to about 5 percent of GDP but the residual gap between investment and domestic savings was only around 1 percent of GDP. This led to the view amongst analysts and some policy makers that capital flows are "excessive" and should be curbed. There is no denying that a major policy challenge is to maintain macroeconomic stability in the face of capital inflows that may not match outflows in timing. As investment is typically prefunded, capital will flow in before it goes out as imports and profits. And this is true for FDI, portfolio inflows, and fixed-income lending. Such asynchronized timing makes life very difficult for macroeconomic policy makers.

Often and perhaps naturally, policymakers tend to give a much higher weight to the short-term problems than to the longer view and this leads to attempts to fine tune capital controls to manage the impact of the inflows. But fine-tuning capital controls rarely works. To quote Glenn Stevens, now Governor of the Reserve Bank of Australia, as he discussed Australia's experience in the 1980s, "[Capital inflows] occurred in spite of capital controls that were still in place, because the distinction between current and capital transactions was blurring and market participants were becoming more adept at circumventing the controls."

Another rationale that is often provided for active capital account management is the belief that by changing relative prices (through taxes and other forms of transaction costs) policymakers can influence the form of the inflows, i.e., foreign direct investment, or portfolio investment, or borrowings. The choice of such taxes is derived from a hierarchy of the relative desirability of different types of inflows. There is little by way of evidence (even from the famed Chilean experiments with controls) that government policy can do better than the market in pricing different forms of capital. At the same time, there is considerable evidence that controls do at least two things: they make capital inflows less transparent by incentivizing agents to disguise them, and they raise the price of capital, especially for small and medium term enterprises. This would appear to be at cross purposes with the need for large capital inflows to ensure continuance of India's high growth. Ultimately, the only way capital controls are known to have worked is when they were imposed in a draconian and blanket fashion. Fortunately, there is no appetite in India for such extreme measures.

Quo vadis, then? Given India's strong medium term fundamentals, it is quite clear that foreign investor interest in India is here to stay. And the timing of such heightened interest is indeed fortuitous as it coincides with the government's recognition of the urgent need to kick infrastructure investment into high gear. So the right strategy is to rapidly put in place reforms of financial, labor and product markets to absorb these inflows efficiently.

India needs to rethink its capital account framework in the light of the need for $500 billion in infrastructure investment. This means refraining from ad hoc changes in capital controls in the name of macroeconomic management, and quickly expanding the country's real and financial absorptive capacity. In particular, there is an urgent need for an expedited and time-bound plan to develop the corporate bond market, including by raising the limits on foreigners' participation in this market, permitting greater capital outflows, creating fiscal space to finance infrastructure investment by curbing wasteful spending, and implementing structural reforms of labor and product markets.

Source: http://www.imf.org/external/np/vc/2008/050408.htm

Reform of IMF Quotas and Indian Voice: Responding to Changes in the Global Economy

On March 28, 2008, the Executive Board of the IMF endorsed a major package of reforms that will enhance the institution's governance. Once approved by the Fund's Board of Governors (they are expected to cast their votes by April 28), the agreement will adjust quota shares to better reflect the relative weight of member countries in the world economy, particularly that of dynamic emerging countries. It will also enhance the voice and representation of low-income countries within the IMF.

The distribution of IMF **quotas** is intended to reflect the relative weight and role of its members in the global economy. But relative quota shares among members have changed only gradually and have not kept up with changing economic realities. Thus, there is a need to rebalance quotas to reflect the many changes that have occurred in recent years, especially the increased weight of major emerging countries in the world economy.

At the same time, there is a need to enhance the voice of low-income countries (LICs) in the IMF. While the weight of these countries in the global economy is small, the Fund plays an important advisory and financing role vis-à-vis these countries. The voting power of LICs has eroded over time, in part because other countries' relative economic weight has increased, in part because the effect on total voting power of "basic votes"-an equal allocation of votes based on the principle of equality of states that was made when the IMF was founded and that has not been increased since-has declined in recent decades with successive rounds of quota increases.

The Multifaceted Role of Quotas

Currently, a member's quota plays a key role in defining four aspects of that member's relationship with the IMF: (1) The amount of financial resources that a member contributes to the IMF; (2) The member's voting power in institutional decision making (along with basic votes); (3) The level of access of the member to IMF financing; and (4) The members' share of general Special Drawing Rights (SDR) allocations.

A Big Step Forward

The Fund's membership recognizes that governance reforms are essential to the continued effectiveness and legitimacy of the institution. At the same time, governance reforms need to be respectful of the interests of the entire membership. Therefore, broad consultation is required n order to reach consensus.

At the time of the IMF Annual Meetings in Singapore in September 2006, the membership endorsed a program to modernize the IMF's governance structure. Country members agreed to a package of reforms to be completed over a two-year timeframe. It comprised the following elements:

- An initial ad hoc increase in quotas for the most underrepresented members: China, Korea, Mexico, and Turkey;
- A new quota formula to guide the assessment of the adequacy of members' quotas in the IMF;
- A second round of ad hoc quota increases based on the new formula;
- An increase in the basic votes that each member possesses to ensure adequate voice for LICs, as well as protection of the share of the basic votes in total voting power going forward; and
- Allocating additional resources for the two Executive Directors representing African members, as their constituencies comprise a fairly large number of countries.

With the exception of the first element that was implemented in 2006, all the other components of the package were endorsed by the Executive Board on March 28.

The aggregate impact of both increases in quotas and basic votes will have a significant bearing for the Fund's membership: 135 countries will increase their voting share. The aggregate shift in voting shares for these countries is 5.4 percentage points, including substantial increases for LICs. Notably, 28 countries will see their voting share more than doubled as a result.

Quota Reviews

Members' quotas are reviewed periodically at intervals of not more than five years. A general review of quotas allows the Fund to assess the adequacy of quotas in terms of its own ability to help meet the financing needs of members. A general review also allows for increases in members' quotas to reflect changes in their relative positions in the world economy. Ad hoc quota increases outside general reviews have been rare in recent decades.

Of the thirteen general reviews that have been conducted thus far, six have concluded that no increase in quotas was needed. The last quota increase under a general review-the Eleventh-took effect in January 1999. The 45 percent overall increase reflected changes in the size of the world economy, the increased risk of financial crisis, and the rapid liberalization of trade and capital flows.

The **Thirteenth General Review**, completed in January 2008, assessed that the aggregate size of total quotas was sufficient to meet the Fund's liquidity requirements, and therefore was no need for an increase. This review was unrelated to the ongoing quota and voice reforms agreed upon by the membership in September 2006.

A single, simpler, and more transparent Formula

The agreement reached on March 28 means that a single quota formula will be used, substituting the five used until now. The old system of formulas is complex and nontransparent, and includes various non-linear elements. These will be replaced by a simpler linear formula based on four updated and modernized variables-GDP, openness, variability and reserves. The advantage of the new formula lies in its simplicity and transparency.

In the new formula, the GDP variable (the one with greater weight) will be a blend of GDP converted at market rates and at purchasing power parity (PPP) exchange rates averaged over a three-year period. The weights of market-based and PPP GDP are 60 and 40 percent, respectively. In the old formulas, GDP was measured solely at market prices for the latest year of available data. The measurement of GDP in PPP terms provides an alternative measure of a member's weight in the global economy that increases the weight of developing countries whose GDP measured at PPP is much higher than their GDP measured at market rates. Unsurprisingly, to have PPP as an element in the formula was a longstanding wish of developing countries.

The Old Quota Formulas

Bretton Woods: $Q_1 = (0.01Y + 0.025R + 0.05P + 0.2276VC)(1 + C/Y)$;

Scheme III: $Q_2 = (0.0065Y + 0.0205125R + 0.078P + 0.4052VC)(1 + C/Y)$;

Scheme IV: $Q_3 = (0.0045Y + 0.03896768R + 0.07P + 0.76976VC)(1 + C/Y)$;

Scheme M4: $Q_4 = 0.005Y + 0.042280464R + 0.044(P + C) + 0.8352VC$;

Scheme M7: $Q_5 = 0.0045Y + 0.05281008R + 0.039(P + C) + 1.0432VC$;

where:

Q_1, Q_2, Q_3, Q_4 and Q_5 = Calculated quotas for each formula;

Y = GDP at current market prices for a recent year;

R = twelve-month average of gold, foreign exchange reserves, SDR holdings and reserve positions in the IMF, for a recent year;

P = annual average of current payments (goods, services, income, and private transfers) for a recent five-year period;

C = annual average of current receipts (goods, services, income, and private transfers) for a recent five-year period; and

VC = variability of current receipts, defined as one standard deviation from the centered five-year moving average, for a recent 13-year period.

For each of the four non-Bretton Woods formulas, quota calculations are multiplied by an adjustment factor so that the sum of the calculations across members equals that derived from the Bretton Woods formula. The calculated quota of a member is the higher of the Bretton Woods calculation and the average of the lowest two of the remaining four calculations (after adjustment).

The New Quota Formula

The new quota formula includes four quota variables (GDP, openness, variability and reserves), expressed in shares of global totals, with the variables assigned weights totaling to 1.0. The formula also includes a compression factor that reduces dispersion in calculated quota shares.

The new formula is:

$$CQS = (0.5*Y + 0.3*O + 0.15*V + 0.05*R)^{k}$$

Where

CQS = calculated quota share;

Y = a blend of GDP converted at market rates and PPP exchange rates averaged over a three year period. The weights of market-based and PPP GDP are 0.60 and 0.40, respectively;

O = the annual average of the sum of current payments and current receipts (goods, services, income, and transfers) for a five year period;

V = variability of current receipts and net capital flows (measured as a standard deviation from the centered three-year trend over a thirteen year period);

R = twelve month average over a year of official reserves (foreign exchange, SDR holdings, reserve position in the Fund, and monetary gold); and

k = a compression factor of 0.95. The compression factor is applied to the uncompressed calculated quota shares which are then rescaled to sum to 100.

The second round of ad hoc quota increases

The proposal endorsed by the Executive Board on March 28 will be put to the Board of Governors, that have a month (until April 28) to cast their votes on the issue. Thereafter, the Amendment to the Articles requires approval by three-fifths of the membership, with eighty-five percent of the total voting power. The individual quota raises, that would represent the second round of ad hoc increases, also need to be agreed by the relevant members. These steps will require action by legislatures in many countries. Therefore, the actual quota increases and other changes that were agreed are expected to become effective within the next few months.

The purpose of the second round of ad hoc increases is to achieve a further rebalancing of quota shares for a broader range of members. Fifty-four countries will see their quota shares increase from pre-Singapore levels by between 12 to 106 percent. Emerging markets are the main beneficiaries: for example, Korea will see its quota increase by 106 percent; Singapore by 63 percent; Turkey by 51 percent; China by 50 percent; India by 40 percent; Brazil by 40 percent; Mexico by 40 percent. The aggregate shift in quota shares for these 54 members is 4.9 percentage points. In contrast, several advanced countries have agreed to forego part of the quota increases for which they are eligible. This group of countries include Germany, Ireland, Italy, Japan, Luxembourg, and the United States.

Changes in Quota and Voting shares[1]						
Quotas				Votes		
Country	Percentage change from pre-Singapore to post second round (Nominal)	Percentage point change from pre-Singapore to post second round (Share)	Post second round quota share (In percent)	Country	Percentage point change from pre-Singapore to post second round (Share)	Post second round quota share (In percent)
Top 10: Positive Change from pre-Singapore				**Top 10: Positive Change from pre-Singapore**		
China	49.6	1.02	4.00	China	0.88	3.81
Korea	106.1	0.65	1.41	Korea	0.61	1.36
India	40.0	0.50	2.44	India	0.42	2.34
Brazil	40.0	0.36	1.78	Brazil	0.31	1.72
Japan	17.4	0.33	6.56	Mexico	0.27	1.47
Mexico	40.2	0.31	1.52	Spain	0.22	1.63
USA	13.2	0.29	17.67	Singapore	0.18	0.59
Spain	32.0	0.26	1.69	Turkey	0.15	0.61
Singapore	63.2	0.19	0.59	Ireland	0.13	0.53
Turkey	51.0	0.16	0.61	Japan	0.12	6.23
Top 10: Negative Change from pre-Singapore				**Top 10: Negative Change from pre-Singapore**		
UK		–0.52	4.51	UK	–0.64	4.29
France		–0.52	4.51	France	–0.64	4.29
Saudi Arabia		–0.34	2.93	Saudi Arabia	–0.41	2.80
Canada		–0.31	2.67	Canada	–0.37	2.56
Russia		–0.29	2.49	Russia	–0.35	2.39
Netherlands		–0.25	2.17	Netherlands	–0.30	2.08
Belgium		–0.22	1.93	USA	–0.29	16.73
Switzerland		–0.17	1.45	Belgium	–0.26	1.86
Australia		–0.16	1.36	Switzerland	–0.19	1.40
Venezuela		–0.13	1.12	Australia	–0.18	1.31
Shift to Countries						
Gaining Share:[2]		4.91			5.42	

Source: Finance Department.

[1]Based on final rounded figures.

[2]For quota shares, sum for the 54 countries that receive ad hoc increases in the second round. For voting shares, sum for the 135 countries that see an increase.

Proposed Quotas for Members Receiving Ad Hoc Quota Increases			
Proposed Quota (In millions of SDRs)		**Proposed Quota (In millions of SDRs)**	
Albania	60.0	Malaysia	1,773.9
Austria	2,113.9	Maldives	10.0
Bahrain	176.4	Mexico	3,625.7
Bhutan	8.5	Norway	1,883.7
Botswana	87.8	Oman	237.0
Brazil	4,250.5	Palau, Republic of	3.5
Cape Verde	11.2	Philippines	1,019.3
Chad	66.6	Poland	1,688.4
China	9,525.9	Portugal	1,029.7
Costa Rica	187.1	Qatar	302.6
Cyprus	158.2	San Marino	22.4
Czech Republic	1,002.2	Seychelles	10.9
Denmark	1,891.4	Singapore	1,408.0
Ecuador	347.8	Slovak Republic	427.5
Equatorial Guinea	52.3	Slovenia	275.0
Eritrea	18.3	Spain	4,023.4
Estonia	93.9	Syrian Arab Republic	346.8
Germany	14,565.5	Thailand	1,440.5
Greece	1,101.8	Timor-Leste	10.8
India	5,821.5	Turkey	1,455.8
Ireland	1,257.6	Turkmenistan	98.6
Israel	1,061.1	United Arab Emirates	752.5
Italy	7,882.3	United States	42,122.4
Japan	15,628.5	Vietnam	460.7
Kazakhstan	427.8		
Korea	3,366.4		
Latvia	142.1		
Lebanon	266.4		
Lithuania	183.9		
Luxembourg	418.7		

The Crucial Trebling of Basic Votes

In order to avoid the erosion in voting share of LICs, the ad hoc increases will not become effective until the amendment to the Articles of Agreement regarding basic votes is approved. That is because enhancing the voice of LICs is a central element of the reform package. A key mechanism for achieving this goal is through an increase in basic votes. Basic votes reflect the principle of equality of states and give the smallest members of the Fund (many of which are LICs), a greater voice in the Fund's deliberations.

The Executive Board recommended a tripling of basic votes, the first such increase since the Fund was established in 1945. This boost is crucial as it will more than compensate many LICs that would have otherwise seem their voting shares diminished. The amendment will also add a provision to the Articles of Agreement that the share of basic votes in total voting power should not decline in the event of future quota realignments.

Why Increase the Number of Basic Votes?

Until early 2008, each IMF member had 250 "basic votes" plus one vote for each SDR 100,000 of its assigned quota. The effect of an increase in basic votes is to increase the voting power of those members whose voting power is below the average voting power for Fund membership as a whole, thereby allowing the smallest members to have an increased measure of influence in the Fund's decision-making process. Successive general increases in quotas had reduced the share of basic votes to 2 percent from 11 percent when the Fund was established, which has led to a weakening of the voice of small developing countries within the Fund. The trebling of the basic votes agreed on March 28 increases the number of basic votes of each member to 750.

Additional Resources for African Executive Directors

The large number of countries represented by the two African chairs and the heavy workload that flows from the important advisory and financing role that the Fund is playing in these countries called for further steps to strengthen the operations of these offices. Consequently, the Executive Board also recommended that each of the two Executive Directors be allowed to appoint an additional Alternate Executive Director.

A First Step Successfully Concluded

The Fund has a global membership and global responsibilities. In order to retain its legitimacy and maintain its effectiveness, Fund members have agreed-after nearly two years of highly technical and sometimes arcane negotiations-to a package of significant reforms. For sure, no country got all that it wanted; but every country got a stronger, more globally representative institution.

The approved quota and voice reform signals the beginning, rather than the end, of a process. It recognizes that country representation will need to adjust to changes in the global economy further down the road. Specifically, the agreement provides that realignments of quota and voting shares will take place every five years-which will result in a further increase in the share of under-represented countries. So, unlike many past international agreements, this one is dynamic, not static.

Source: http://www.imf.org/external/np/exr/ib/2008/040108.htm

World Bank Supports India's Elementary Education Program with US$600 Million

WASHINGTON, May 15, 2008 - The World Bank today approved a US$600 million credit to support the Government of India's ongoing Sarva Shiksha Abhiyan (SSA), a nationwide centrally sponsored education program designed to provide all children aged 6 to 14 with education of satisfactory quality.

The Second Elementary Education Project aims to improve quality and access to this critical social service. The project also aims to promote equity by enabling hard-to-reach children to attend school. It will create better learning conditions for all children and provide capacity building and academic support to state and sub-state education structures. In the area of oversight, the project will help monitor learning outcomes and support research and evaluation of quality initiatives.

India has made strong progress in enhancing access to education. In 2002, India made elementary education a fundamental right of every child through its 86th constitutional amendment. Between 2003 and 2005, the number of out-of-school children was reduced from 25 million to about 13.4 million. The transition rates from primary to upper primary also improved, from 75 percent in 2002 to 83 percent in 2006. There has been a significant reduction in gender gaps. Access for children from marginalized groups, minorities, extremely poor households, and educationally and economically lagging states has increased.

"The Sarva Shiksha Abhiyan program has served as a powerful vehicle to mobilize stakeholders at all community, district, state, and national levels around the objective of ensuring that every child from 6 to 14 years is included in the education system," said Isabel Guerrero, World Bank Country Director for India. "The challenge now is to include those hardest to reach and to ensure that children get the quality education which is a critical foundation for both higher levels of education and creating the skills needed to have a significant impact on economic development."

The project is the second phase of support by the development partners to the government's ongoing and evolving SSA program. With more and more children now entering school, the focus in this next phase is on quality with equity. In addition to capacity building and monitoring, the project will also support plans to enable the hard-to-reach children to attend school. In areas where access to education remains low, it will support provision of teachers and construction of primary and upper primary schools. It will also support provision of free textbooks and grants to private aided schools to encourage them to subsidize enrolment of students.

"The first phase of development partners' support to the program saw a rapid expansion of primary school facilities across the country, especially in remote and socially disadvantaged areas," said co-team leaders Amit Dar, World Bank Lead Education Economist, and Venita Kaul, World Bank Senior Education Specialist. "SSA II focuses on moving towards the achievement of quality goals and improved learning outcomes. Achieving these goals will play a big role in moving towards the achievement of the education Millennium Development Goals on a global scale."

Total cost of the SSA II is estimated at US$10.7 billion, of which the states of India will contribute close to 36.9 percent, the Government of India will contribute around 53.7 percent and development partners 9.4 percent.

Source: http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:21769659~pagePK:64257043~piPK:437376~theSitePK:4607,00.html?cid=3001

World Bank Support to India

The World Bank works in close partnership with India's Central and State Governments, aligning its strategies with the country's own development agenda. It lays emphasis on investing in people through better health and education, empowering communities to participate in their own development, improving the effectiveness of government, and promoting private sector-led growth to achieve the country's development goals.

Its four-year **Country Strategy for 2005-2008** focuses on lending for infrastructure, human development, and improving rural livelihoods. The Bank is increasingly focusing on providing analytical reports on the country's major development challenges, and extending practical advice to policy makers by sharing good practices and experience from within the country and abroad.

Lending

India is one of the oldest members of the World Bank having joined the institution in 1944. New World Bank lending to the country in FY07 (July 2006-June 2007) was US$3.7 billion. At end of June 2007, the Bank group had 67 active projects with a net commitment of about US$ 14.3 billion for these projects.

Commitments	FY 02	FY 03	FY 04	FY 05	FY 06	FY 07
New	2.2	1.5	1.4	2.9	1.4	3.7
Total Commitments (Active Projects)	13.	13.0	12.0	12.8	11.3	14.3
Total No. of Active Projects	69	70	63	64	56	67

Source: http://www.worldbank.org.in/WBSITE/EXTERNAL/COUNTRIES/SOUTHASIAEXT/INDIAEXTN/

India and International Finance Corporation

Since 1956, IFC has invested in 199 companies in India, providing nearly $4.33 billion in financing for its own account and $1.02 billion for the accounts of participants in IFC's loan syndication program.

Our held portfolio of $2.3 billion (as of June 2007) makes India IFC's third largest country of operations. In recent years, we have grown our business substantially, with largest commitments of $1.05 billion in FY07.

To reduce poverty and promote sustainable economic growth, we believe that India needs a vibrant private sector which will:

- increase the availability of high-quality infrastructure
- accelerate rural growth
- develop competitive manufacturing and service industries
- strengthen the financial sector

We are therefore focusing our activities on supporting:

- private sector involvement in infrastructure financing
- restructuring and modernization of the manufacturing and services sectors to become internationally competitive
- the development of new financial institutions and products

We are committed to working on the frontiers of private investment, helping bring commercial disciplines and entrepreneurial dynamism to new areas of the economy. We therefore also support private investment in health and education, and innovative applications of information technology.

IDA and India

Challenge

The 1990s saw remarkable improvement in education indicators in India. Between 1992/93 and 1998/99, net enrollment of the 6-to-10 age group increased from 68 percent to 82 percent across the nation. In rural areas, girls' net enrollment jumped from 55 percent to 76 percent, and boys from 72 percent to 84 percent. Despite these achievements, some 39 million children or about 21 percent of the 6-to-14 age group were still out of school and Grade 5 completion rate was under 78 percent nationwide in 1999-2000. Wide-ranging disparities were prevalent across states and districts. For example, the net primary enrollment ratios ranged from 63 percent in Bihar to 98 percent in Kerala. Inequity across scheduled castes and scheduled tribes was pronounced.

Approach

- The World Bank has a long history of supporting India's District Primary Education Program, which has been operating in 273 districts in 17 states since the mid-1990s.

- The Elementary Education project known as Sarva Shiksha Abhiyan (SSA) is a centrally-sponsored scheme operating in a large federal system in which the states are responsible for providing and financing elementary education.
- The project takes a sector-wide approach wherein the development partners agree on their financial contributions to the government's program and rely on the government's own rules and procedures for implementing the program.
- Among other activities, the government's program financed innovative state-led initiatives to get children into school, salaries for new teachers, free textbooks for girls and disadvantaged students, provision of teaching and learning materials, setting up local-level institutions to provide support services to schools and teachers, and monitoring and evaluation.

Results

The number of Indian children out of school went down from 25 million in 2003 to about 7 million in 2006 (exceeding the target), thus steadily moving towards universal enrolment (about 185 million children were enrolled at the elementary level in 2006).

Highlights

- With regard to equity, the gender gap has reduced. At the elementary level, the share of girls enrolled (as a percentage of total enrolment) is 46 percent compared to a baseline of 44 percent (which is close to the proportion of girls in this age group in the population).
- The social gap has also narrowed with an increase in Scheduled Caste enrolment at primary level from 18.9 percent in 2002 to 21.3 percent in 2006 which reflects parity with their share in the overall population (16.2 percent). Similarly the Scheduled Tribe enrollment has also increased from 10.3 percent in 2002 to 11 percent in 2006.
- More children are now moving from the primary cycle to the upper primary cycle, with transition rates from Grade 5 to Grade 6 increasing from a baseline of 75 percent (2003) to 83 percent in 2006.

IDA Contribution

- The total cost of the program was US$3.5 billion of which three development partners contributed $1 billion: IDA's contribution was US$500 million, the UK's (Department for International Development) was US$346 million, and the European Commission's was US$200 million. The government of India contributed $1.58 billion, with a matching contribution of $875 million from the states.
- IDA significantly increased the overall resource envelope, which has played an important role in the scaling-up of the program.
- Furthermore, by supporting the strengthening of the feedback system already being used by the government of Inida for continuous review of program

design and implementation, the central government, states and districts have been able to make better decisions regarding the allocation of financial resources and adjustment of policy and practices.

- IDA has also provided technical support for undertaking studies and an impact evaluation of various aspects of the program – learning assessment, teacher accountability and contracting, public expenditure tracking – which are being fed into improving the design of the program.
- Furthermore, dialogue has now led to greater attention being paid to education quality issues.

Further Steps

Owing to delays in collecting data, any change in learning levels over the baseline cannot yet be measured, but various reports indicate that improving quality is a challenge that still needs to be tackled. IDA and the other development partners are now working with the government of India to develop the second phase of SSA, with the main objective being to improve the quality of education at the primary level as well as providing access to the most disadvantaged.

WTO Proposals: India Inc expresses disappointment

Indian industry on Tuesday expressed disappointment over World Trade Organisation's revised proposals on duty cuts and subsidy reduction in agriculture and industrial products to reach a global trade deal.

Country's apex business chambers — CII, Ficci and Assocham — have said the WTO draft on Non-Agriculture Market Access (NAMA) under the Doha Round of trade talks was in complete disregard to the mandate of the round, which had to revolve around lesser obligation on the developing countries for duty reduction.

"The new draft has again failed to follow the Doha mandate of 'less than full reciprocity' in tariff reduction," industry body Ficci said in a statement.

The trade-off between the co-efficients and flexibilities as proposed in the new text go against the development dimension of the Doha declaration, CII (WTO and Trade Agreements Committee) Chairman Gopalakrishnan said.

Referring to the new proposal on re-manufactured goods by Japan, US and Switzerland enclosed in the new NAMA text, Gopalakrishnan said the chamber is against any proposal that attempts to liberalise trade in such goods. He added there is a need for far greater study on this issue before including it in the negotiations.

The draft only says that no tariff shall be bound in a form more complex than the current form of tariff. In NAMA, developed countries have demanded the conversion of all specific duties into ad valorem, but in agriculture the same nations are not ready to convert tariff lines into ad valorem tariffs, which would lend greater transparency, Ficci said.

Source: http://www.hindu.com/thehindu/holnus/001200805201923.htm

WTO and India: India to resist scaling down farm protection under Doha talks

NEW DELHI: Ahead of the release of fresh WTO proposals, India has conveyed to the agricultural negotiating group in Geneva that chances of a Doha deal will become bleak if the US has its way on scaling down protection to farmers in developing countries.

“It will become clear in the next few days whether the US and other developed countries are serious to conclude the Doha negotiations, which have dragged for seven long years,” a senior commerce ministry official said.

The Chairman of the Negotiating Group on Agriculture, Mr Crawford Falconer has concluded three-month old official-level discussions with a large number of WTO member countries and is expected to release the fresh draft in the next few days.

India along with other members of the G-33 (a group of countries with protective interest) is apprehensive of the US exerting pressure on the negotiating group to cut the number of special products (SPs), on which the developing countries are allowed to remain non-committal in duty reduction.

While the last negotiating text released in February this year had proposed that between 12-20 per cent of the total agriculture items can be designated as SPs, the US along with eight other exporting countries have suddenly brought in a proposal of rest ricting the protection level to 8 per cent.

“This is a bogus proposal and is totally unacceptable. They (the US) themselves come out with hot balloons and then have the audacity to point fingers at India, Brazil and China that we are not being constructive,” the official said.

He said India’s “loud and clear” message was also conveyed to US Trade Representative Ms Susan Schwab by the Commerce and Industry Minister, Mr Kamal Nath at their last meetings in New York on May 7 and 8. - PTI

http://www.thehindubusinessline.com/blnus/07141606.htm

US keen on India to join International Energy Agency

New Delhi, May 22 (PTI) The US wants India to increase its engagement with the International Energy Agency (IEA), set up in the mid-1970s to help developed nations manage oil supplies during emergencies, and finally join the grouping. ”We think it is increasingly important to have some of the most important economies and energy consumers such as India more deeply involved in the IEA,” US Assistant Secretary (Bureau of Economic, Energy and Business Affairs) Daniel Sullivan told reporters here.

He said India and China have been invited to participate in an emergency response exercise next month and “a logical step beyond that would be consideration of the membership”.

The membership of the IEA, he said, would be beneficial to India with regard to developing energy policy and managing strategic reserves.

Deeper cooperation, the US official said "would be a win-win for the organisation, the US, India and China." Sullivan, who arrived here from China, met senior officials in several ministries including External Affairs, Finance, Commerce, Power and New and Renewable Energy.

During his meetings with Indian officials, he also discussed the recently released WTO texts on industry and agriculture.

About the US response to these new texts, Sullivan said the government was studying the documents.

Attributing the high crude prices to rapid increase in demand witnessed in the last couple of years, he said the way to deal with the problem is through energy efficiency and diversification of energy sources.

Source: http://www.ptinews.com/pti%5Cptisite.nsf/0/4DD17065D74A9 FD5652574510032C676?OpenDocument

V. CHART OF PRODUCT LIFE CYCLE OF INTERNATIONAL PRODUCT

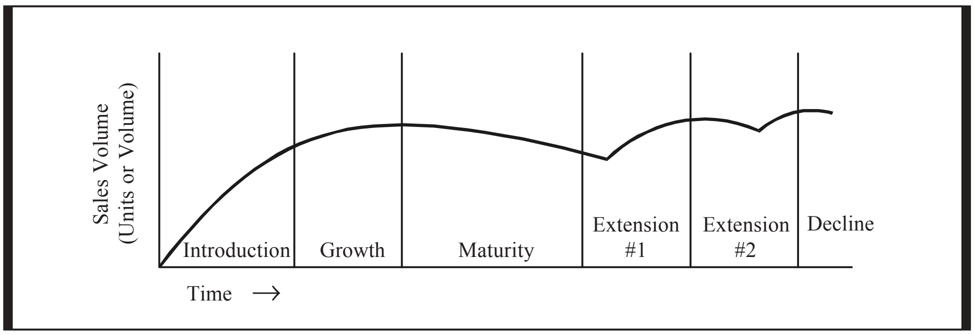

Fig. Extending the Product Life Cyclextending the Product Life Cycle/ Product Life Cycle of International Product

VI. DESCRIPTION OF PROCEDURES FOLLOWED IN RECRUITMENT/ELECTION OF AT LEAST ONE MNC IN INDIA

1. Position Terms of Reference(TOR) and Budget Approval

↓

2. Get Clearance for Immigration Authorities of the Country Concerned, Based on the Rules/ Restrictions

↓

3. Gain Approval for direct appointment, if employee referrals are available

(OR)

3. Proceed with full process of Recruitment and Selection

↓

4. Draft Position Advertisement

↓

5. Gain Approval for Advertisement

↓

6. Advertise Position in Selected publications and on websites

↓

7. Receive and Acknowledge Applications

↓

8. Establish Selection Panel

↓

9. Review Applications for Compliance with job designations and Requirements

↓

10. Exclude and Notify non- compliant/ unsuccessful applicants

↓

11. Undertake Short-Listing with selection Panel

↓

12. Notify short-listed applicants

↓

13. Establish Interview Arrangements

↓

14. Undertake referee checks of short listed candidates

↓

15. Invite short-listed applicants for interview

↓

16. Arrange Interview Panel and Supply relevant material to them

17. Check the Applicant's and family members' cultural background with cultural requirements of the country and assess cultural adaptability

18. Assess the applicant's technical competency

19. Identify most suitable applicant

20. Complete Selection Report

21. Provide Selection Report to all relevant managers

22. Notify Successful Applicant along with contract details

23. Finalize and arrange for execution of contract

24. Notify short listed unsuccessful applicants

25. Arrange visa, tickets etc. to successful applicant and family members

26. Language and Cultural training to successful applicant and family members in their current place before departure

27. Receive Successful applicant and family members

28. Induct Successful applicant

29. Socialize and orient Successful applicant and family members