



GLOBAL BUSINESS OPERATIONS AND INSTITUTIONS

COURSE CODE: M21CM06DC

Postgraduate Programme
Discipline Core Course
Master of Commerce

SELF LEARNING MATERIAL



SREENARAYANAGURU
OPEN UNIVERSITY

SREENARAYANAGURU OPEN UNIVERSITY

The State University for Education, Training and Research in Blended Format, Kerala

SREENARAYANAGURU OPEN UNIVERSITY

Vision

To increase access of potential learners of all categories to higher education, research and training, and ensure equity through delivery of high quality processes and outcomes fostering inclusive educational empowerment for social advancement.

Mission

To be benchmarked as a model for conservation and dissemination of knowledge and skill on blended and virtual mode in education, training and research for normal, continuing, and adult learners.

Pathway

Access and Quality define Equity.

Global Business Operations and Institutions

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Semester - II

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Master of Commerce
Self Learning Material
(With Model Question Paper Sets)



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MESSAGE FROM VICE CHANCELLOR

Dear learner,

I extend my heartfelt greetings and profound enthusiasm as I warmly welcome you to Sreenarayanaguru Open University. Established in September 2020 as a state-led endeavour to promote higher education through open and distance learning modes, our institution was shaped by the guiding principle that access and quality are the cornerstones of equity. We have firmly resolved to uphold the highest standards of education, setting the benchmark and charting the course.

The courses offered by the Sreenarayanaguru Open University aim to strike a quality balance, ensuring students are equipped for both personal growth and professional excellence. The University embraces the widely acclaimed “blended format,” a practical framework that harmoniously integrates Self-Learning Materials, Classroom Counseling, and Virtual modes, fostering a dynamic and enriching experience for both learners and instructors.

The university aims to offer you an engaging and thought-provoking educational journey. This material for MCom learners focuses on international business complexities. It combines theory and practice to illustrate how companies operate globally and interact with world institutions. Using case studies, the material explores international trade, multinational operations, and global regulatory environments. Learners will enhance their analytical and decision-making skills for effective management in the global business landscape. The Self-Learning Material has been meticulously crafted, incorporating relevant examples to facilitate better comprehension.

Rest assured, the university’s student support services will be at your disposal throughout your academic journey, readily available to address any concerns or grievances you may encounter. We encourage you to reach out to us freely regarding any matter about your academic programme. It is our sincere wish that you achieve the utmost success.



Warm regards,
Dr. Jagathy Raj V. P.

16-08-2024

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01 BLOCK

GLOBAL BUSINESS

Block Content

Unit - 1 Global Business

Unit - 2 Mode of Entry

Unit 1

Global Business

Learning Outcomes

On completion of the course, the learners will be able to:

- ◆ get an awareness on the concept of international business and analyze the drivers of international business.
- ◆ describe the significance of international business.
- ◆ explain the concept of globalization
- ◆ differentiate between domestic business and global business

Background

All business enterprises aspire to carry out global business. Global or international business focuses on global resources and opportunities to buy or sell worldwide. Understanding international business is essential in today's interdependent global world. Global business is not a new phenomenon. Trade across the globe is as old as business. The concept of international business is a broader concept relating to the integration of economies and societies that dates back to the 19th century. However, the volume of international trade and the number of players has increased dramatically over the last two decades. Several developments around the world have helped to fuel this activity. The term international business has emerged from the term international marketing which in turn emerged from the term international trade. The efforts of the IMF, World Bank, and WTO, along with the efforts of individual countries due to the limitations of closed economies, led to the globalization of business. Globalization accelerated the growth of international business. Now, global corporations consider the whole world as their production place and the market. They assemble the factors of production wherever they can make it optimally. Ownership and management have become transnational. In its traditional form of international trade and finance as well as its newest form of multinational business operations, international business has become massive in scale. It has a major influence over the political, economic, and social environments of the business.

Keywords

Global and domestic business, Drivers, Scope, Globalization

Discussion

1.1.1 Meaning

International business refers to business activities that take place beyond the geographical limits of a country. It involves the international movements of goods and services and capital, personnel, technology, and intellectual property like patents, trademarks, know-how, and copyrights. International trade, thus refers to the exchange of goods and services between one country or region and another. It is also sometimes known as “inter-regional” or foreign” trade. Briefly, trade between one nation and another is called “international” trade, and trade within the territory (political boundary) of a nation is “internal” trade. International Business involves cross-border transactions of goods and services between two or more countries. Transactions of economic resources include capital, skills, and people for the international production of physical goods and services such as finance, banking, insurance, and construction. At its core IB involves the exchange of goods, services and capital across national borders.

◆ Trade across national borders

International business includes transactions that involve crossing national boundaries. They are:

- ◆ Product presence in different markets of the world
- ◆ Production bases across the globe
- ◆ Human resources to contain a high diversity
- ◆ Investment in international services like banking, advertising, tourism, retailing, and construction.
- ◆ Transactions involving intellectual properties such as copyrights, patents, trademarks, and process technology.

International trade takes place on account of many reasons such as:

- a. Human wants and countries’ resources do not always coincide. Hence, there tends to be interdependence on a

- large scale.
- b. Factor endowments in different countries differ.
- c. Technological advancements of different countries differ. Thus, some countries are better placed in one kind of production and some others superior in some other kind of production.
- d. Labour and entrepreneurial skills differ in different countries.
- e. Factors of production are highly immobile between countries.

Inshort, international trade is the outcome of the territorial division of labour and specialization in the countries of the world.

1.1.2 Definitions of Global Business

According to the International Business Journal, “International business is a commercial enterprise that performs economic activity beyond the bounds of its location, has branches in two or more foreign countries and makes use of economic, cultural, political, legal and other differences between countries”.

According to John D. Daniels and Lee H. Radebaugh, International business is all business transactions-private and governmental- that involve two or more countries. Private companies undertake such transactions for profits; governments may or may not do the same in their transactions.

1.1.3 Features of Global Business

a. Large scale operations

In International business, all the operations are conducted on a massive scale. Production functions and marketing activities are carried out on a very large scale because they have to meet the demands of the global market. The product is also marketed on a large scale to make consumers aware of the company’s products and services. The business organisations initially sell their goods in the local market, and then the surplus goods are exported to other countries.

b. Integration of Economies

International business integrates the economies of many countries. Companies use various production factors such as finance, labour, resources, and infrastructure in other countries where they are working. The product idea may be conceived in one country, the product designs may be fixed in another country, and the firm produces its parts in many different countries, assembles them in another country, and sells them in many countries.

c. Benefits to participating Countries

Global business benefits the countries that participate in international business. The developed countries grow their business to the global level, and they get maximum benefits. The developing countries get the latest technology, foreign capital, employment opportunities, rapid industrial development, etc, at a lower cost. This helps developing countries in developing their economy. Therefore, developing countries open up their economy to foreign investments.

d. Market Segmentation

International business is based on market segmentation based on the geographic segmentation of consumers. The market is divided into different groups according to the demand of consumers in various countries. It produces goods according to the demand of the consumers of the other market segmentations.

e. Keen Competition

International business has to face competition in the world market. There are many competing firms, and the competition is between unequal partners. In this situation, the developed countries are in a favourable position as they produce superior quality goods and services, but developing countries need help to face competition.

f. Dominated by developed countries

International business is dominated by developed countries and their MNCs. Countries like the U.S.A., Europe, and Japan are producing high-quality products. They have sufficient human capital. They have large financial and other resources like the best technology and research and development centres. Therefore, they produce high-quality products and services at low prices. They help them to capture the world market.

g. International Restrictions

International business faces many restrictions on the inflow and outflow of capital, technology and goods. Many governments do not allow other participants to enter their countries. They confront many trade blocks, tariff barriers, foreign exchange restrictions, etc. All these regulations impede the process of international business.

h. Special role of science and technology

International business depends heavily on science and technology. Science and technology help the business to have



a large-scale production at a minimal cost. Developed countries use high technology. International business helps them to transfer top-end technology to developing countries.

i. Sensitive Nature

International business is highly affected by economic policies, political environment, technology, etc. It can play a positive role in improving the business and can also be negative for the business. It totally depends on the policies made by the government; it can help in expanding the business and maximizing the profits and vice-versa.

1.1.4 Significance of Global Business

a. Helps to achieve higher rates of profit

The basic objective of any business firm is to earn maximum profit. When the domestic markets do not promise a higher rate of profit, business firms search for a global market that provides higher rates of profit. The profit maximization objective of businesses motivates them to expand their operations to foreign countries.

b. Wider market

When the home market size is limited due to the smaller size of the population or the lower purchasing power of people, the companies internationalize their operations. For example, most of the Japanese automobile companies entered other countries because of limited home market.

c. Availability of modern technology and competent human resources

The availability of advanced technology and highly skilled human resources in some countries encourages companies to internationalize their businesses. International business helps in assembling various factors of production at a lower cost.

d. Increase in market share

Large-scale operations help business firms to increase their market share. Smaller companies expand internationally for survival while the more giant corporations expand to increase their market share.

e. Socio-economic welfare

Global business enhances the consumption level and economic welfare of the people in trading countries. It helps governments to achieve a higher growth rate of the economy, increase total and per capita GDP, industrial growth, employment and income levels.

f. High living standards

Through international business, customers in various countries can buy more products with the same amount of money. The products are available at low cost and high quality. In turn, it enhances the living standards of the people through enhanced purchasing power and by consuming high-quality products.

g. Reduced risks

Both commercial and political risks are reduced for the companies engaged in international business due to their spread in different countries. The impact of political instabilities can be overcome to a large extent through international business.

h. Exploration of potential untapped markets

International business provides the chance to explore and exploit potential markets that have not been explored so far. These markets offer the opportunity for selling the product at a higher price than at domestic markets.

i. Overall economic growth

Specialization, enhancement of productivity, division of labour, innovations, and creations to meet the competition lead to the overall economic growth of the world nations.

j. Optimum and proper utilization of world resources

Global business provides for the flow of raw materials, natural resources, and human resources from countries where they are in excess supply to countries that are in short supply or extreme need. It helps in the optimum and proper utilization of world resources.

k. Cultural transformation

Global business reaps not only economic or commercial benefits but also social and cultural benefits. It helps to have a close cultural transformation and integration.

1.1.5 Drivers of International Business

a. Developing countries have huge markets

For companies in developed countries which have been operating below their capacities, the developing markets offer immense opportunities to increase sales and profits.

b. Low wage cost

Many Multinational Corporations are locating their subsidiaries in low-wage countries to take advantage of the low-cost production. This is especially important when labour accounts

for a large portion of total production costs. Many car makers have set up their operations in India because of low wage rates. However, the lower wage rates of a nation need to be balanced against its potentially lower productivity.

c. Regional trading blocks

Regional trading blocks are adding to the pace of globalization. Every trading block seeks to promote international business by removing trade and investment barriers. Integration among countries results in efficient allocation of resources throughout the trading area, promoting the growth of some businesses. It also helps in the development of new technologies and products and the elimination of the old. Examples of regional integrations are WTO, NAFTA, SAARC, ASEAN, etc.

d. Declining trade and investment barriers

In the early period of the 20th century, countries fixed high levels of barriers in trade and investment. Such restrictions aim to protect domestic industries. It resulted in depression, and countries have gradually dismantled the barriers. As a result, the business across the globe has grown considerably.

e. Technology

The most powerful instrument that has triggered internationalization is technology. Significant changes are witnessed in communication, transportation, and information processing with the emergence of the Internet. With these technological developments, MNCs can locate production facilities anywhere in the world to take advantage of low-cost production. This trend helps in creating job opportunities in several countries.

f. Resource seeking

Resources can be natural or strategic assets. There are three categories of natural resources. First, there are those seeking physical resources, which include mineral fuels, industrial minerals, metals and agricultural products. The second resource group is plentiful supplies of cheap and well-motivated unskilled or semiskilled labour. The third type of resource is technology. Strategic assets include a global portfolio of physical assets and human competencies that add to a firm's competitive edge. Strategic asset seekers aim to capitalize on the benefits of the common ownership of diversified activities and capabilities.

g. Treaties and Conventions

Treaties and conventions signed and binding on member countries facilitate international business considerably. The Treaty of Rome, Paris Convention, and Chemical Weapons Con-

ventions, etc, are a few examples of international treaties and conventions facilitating international business.

1.1.6 Scope of International Business

a. Foreign Investments

Foreign investments are an important aspect of international business. Foreign investment contains investments of funds from outside countries in exchange for financial return. Foreign investments are made through investments in foreign countries through international business. Foreign investments are of two types. They are direct investments and portfolio investments.

b. Exports and Imports of Merchandise

Merchandise is tangible goods. (Those goods which can be seen and touched.) Merchandise export means sending the home country's goods to other countries, and merchandise imports mean bringing tangible goods to the home country.

c. Licensing and Franchising

Franchising means permitting the new party of the foreign country in order to produce and sell goods under your trademarks, patents or copyrights in exchange for some fee. The licensing system refers to companies like Pepsi and Coca-Cola, which are produced and sold by local bottlers in foreign countries. Franchising and licensing have also come under the scope of international business.

d. Service Exports and Imports

Services exports and imports consist of intangible items which cannot be seen and touched. The trade between the countries of the services is also known as invisible trade. There is a variety of services like tourism, travel, boarding, lodging, construction, training, education, financial services, etc. Tourism and travel are major components of international business and services.

e. Growth Opportunities

There are lots of growth opportunities for developing and underdeveloped countries by trading with each other at a global level. The imports and exports of the countries maximize their profits and help them to grow at a global level.

f. Benefitting From Currency Exchange

International business also plays an important role in currency exchange as one can take advantage of currency fluctuations. Countries can take advantage of currency fluctuations when they operate at a global level.

◆ Outside investments

◆ Tangible goods

◆ Agreements

◆ intangible

◆ Grow globally

◆ Currency fluctuation



g. Limitations of the Domestic Market

- ◆ Explore foreign markets

If the domestic market of a country is small, then the international business is a good option for the growth of the business in the host country. The depression of domestic market firms will force them to explore foreign markets

1.1.7 Differences between Domestic and Global Business

Characteristically, there are marked differences between internal and international trade as stated below:

- ◆ Buying and Selling across nations

◆ Specific Terms: Exports and Imports

Internal trade is the exchange of domestic output within the political boundaries of a nation, while international trade is the trade between two or more nations. Thus, unlike internal trade, the terms “export” and “import” are used in foreign trade. To export means to sell goods to a foreign country. To import goods means to buy goods from a foreign country.

- ◆ diversified

◆ Heterogeneous Group

An obvious difference between home trade and foreign trade is that trade within a country is trade among the same group of people, whereas trade between countries takes place between differently cohered groups. The socio-economic environment differs greatly between nations, while it is more or less the same within a country. Frederick List, therefore, said: “Domestic trade is among us, international trade is between us and them”.

- ◆ Conflict of interest

◆ Political Difference

International trade occurs between different political units, while domestic trade occurs within the same political unit. The government in each country is keen on the welfare of its nationals against that of the people of other countries. Hence, in international trade policy, each government tries to safeguard its interests at the cost of those of the other country.

- ◆ Currency difference

◆ Different Currencies

Perhaps the principal difference between domestic and international trade is that the latter involves the use of different types of currencies and each country follows different foreign exchange rates. Thus, one has to study not only the factors that determine the value of each country’s monetary unit but also the divergent practices and types of exchange resorted to.

f. Heterogeneous World Markets

In a way, home trade has a homogeneous market. In foreign trade, however, the world markets lack homogeneity on account

◆ Diversified market

of differences in climate, language, preferences, habits, customs, weights and measures, etc. The behaviour of international buyers in each case would, therefore, be different. For instance, Indians have right-hand-drive cars, while Americans have left-hand-driven cars. Hence, the automobile market is effectively separated. Thus, one peculiarity of international trade is that it involves heterogeneous national markets.

◆ Immobility of men and money

g. Factors of Immobility

Another major difference between internal and international trade is the degree of immobility of factors of production like labour and capital, which are generally greater between countries than within the country. Immigration laws, citizenship qualifications, etc., often restrict the international mobility of labour. International capital flows are prohibited or severely restricted by different governments.

◆ Varied rule

◆ Different Rules

National rules, laws, and policies relating to trade, commerce, industry, taxation, etc., are more or less uniform within a country but differ widely. Tariff policy, import quota system, subsidies, and other controls adopted by a government interfere with normal trade between it and other countries. Thus, state interference causes different problems in international trade.

◆ unified global system

1.1.8 Globalization

In simple terms, globalization refers to the economic integration of the world. The key characteristics of globalization include:

- ◆ Liberalization of world trade.
- ◆ Expansion of Foreign Direct Investment.
- ◆ Massive cross-border financial, technical, and human flows.
- ◆ Coordination of cross-border manufacturing and marketing activities.

Globalization has been accompanied by the creation of new institutions to work across borders and has led to renewed attention to long-established international intergovernmental institutions. Globalization has promoted open societies and open economies and encouraged the free exchange of goods, ideas, and knowledge. Innovation, creativity, and entrepreneurship have flourished in many parts of the world. Globalization has reduced the sense of isolation felt in much of the develop-

ing world and has given many people in poor countries access to knowledge. It has spread the spirit of democracy to countries ruled by dictators. It is also very helpful in minimizing human rights violations.

1.1.8.1 Benefits of globalization

a. Regional integration

- ◆ Integration of countries

The regional integration of the countries of the same region or area increases the size of the market, aggregate demand for products and services, quantity of production, employment, and, ultimately, the region's economic activity. Further, the region's people get a variety of products comparatively at lower prices.

b. Declining trade barriers

- ◆ Tariff reduction

Another benefit of globalization is the declining trade barriers. International trade occurs when the goods flow across the countries. The government used to impose trade barriers like quotas and tariffs to protect domestic businesses from the competition of international businesses. Advanced countries after World War II agreed to reduce tariffs to encourage the free flow of goods.

c. Declining investment barriers

- ◆ Barriers on foreign investment

Global business firms invest capital to establish manufacturing and other facilities in foreign countries. Foreign governments impose barriers on foreign investment to protect domestic industry. However, various countries have been removing these barriers to foreign direct investment to encourage the growth of global businesses.

d. Growth in Foreign Direct Investment

- ◆ Investments in new or existing facilities

The investment made by a company in new manufacturing and or marketing facilities in a foreign country is referred to as Foreign Direct Investment. There are several reasons for the growth of FDI in recent years. These reasons include an increase in sales and profits, reduced costs, consolidated trade blocks, etc.

e. Spurs economic development

- ◆ Improved standard of living

Theoretically, globalization gives poorer countries access to foreign capital and technology they would not otherwise have. Foreign investment can result in an improved standard of living for the citizens of those nations.

1.1.9 Impact of Globalization

Globalization has led to trade specialization by integrating global markets and allowing countries to focus on producing

◆ Specialization in trade

goods and services where they have a comparative advantage. This means countries concentrate on what they can produce most efficiently and trade for what they cannot, enhancing overall economic productivity. For example, nations rich in natural resources may specialize in raw material extraction, while those with advanced technology focus on manufacturing. This specialization reduces costs, improves quality, and benefits from economies of scale. Moreover, globalization promotes the exchange of knowledge and technology, further refining production processes. Multinational corporations facilitate this by spreading best practices and innovations across borders. Consequently, globalization creates a more interconnected and prosperous global economy, where countries are interdependent and benefit from each other's strengths.

◆ More choices

As we shall see in the text, there are numerous other reasons why we might generally expect globalization to generate aggregate benefits for a country that embraces open trade. First, being open to trade permits consumers to take advantage of the excellent variety of available goods in a closed domestic market. This process permits more choices regarding qualities and prices while reducing the cost to households in order to achieve a given level of consumption benefits. Similarly, domestic enterprises gain access to a wider variety and quality range of inputs they can put into their production processes, thereby raising productivity.

◆ Eliminate hindrances on exporting

Globalization expands the size of markets into which domestic producers can sell their goods as exports, giving them more opportunities to benefit. A recent study of the impacts of Vietnam's 1993 decision to eliminate its restrictions on exporting rice found substantial income gains for that country's rice producers, with a significant reduction in rural poverty and a reduction in the use of child labour.

◆ Efficiency

Foreign competition often breaks down inefficient domestic monopolies, bringing prices down closer to the cost of production and making consumers better off. For example, in numerous developing countries, the decision in the 1990s to open their telecommunications industries to international entry has dramatically expanded the range of services for domestic consumers. A related outcome is that greater exposure to global competition often forces inefficient domestic firms to reduce their output or even shut down if they cannot invest sufficiently in greater productivity. Economists think of this rationalization of production as a benefit, for it releases labour and capital from inefficient use into more productive firms or new investments. It is globalization equivalent to the familiar concept of creative destruction through competition and innovation.



◆ Technology transfer

A further significant gain from globalization comes from the information content of imports, FDI, and licensing. Imported capital goods may be more efficient than those produced domestically. Multinational enterprises and licensed joint ventures typically bring more advanced technologies or superior means of production, often resulting in higher productivity in domestic firms. These “spillovers” may happen in a variety of ways, including simple copying of technologies and products, the leaking of such information as engineers change jobs, and the sharing of technical standards the multinational firm and its input suppliers.

◆ Opportunities for skilled labours

Globalization offers significant opportunities for skilled labour by expanding job markets and increasing demand for specialized expertise. Skilled workers can access higher-paying jobs and diverse career options globally, beyond their home countries. Multinational companies often seek skilled professionals to enhance competitiveness, leading to better employment prospects and career growth. Additionally, globalization fosters knowledge exchange and continuous learning, enabling workers to stay updated with the latest industry trends and technologies. This interconnectedness not only boosts individual career development but also drives innovation and economic growth on a global scale.

◆ Negatively affect the rural farmers

This positive view of international trade surely cannot be the entire story, however, since there are frequent news items about people losing their jobs to import competition or outsourcing and entire towns being devastated by the closure of manufacturing plants that were primary employers. Many analysts at certain non-governmental organizations (NGOs) argue that because farmers in poor countries cannot compete with subsidized agriculture in developed countries, greater trade exposure forces them to leave their land, causing rural poverty.

◆ Environmental pollution

Others note that the increased economic activity caused by expanding flows of trade and investment places excessive stress on the use of natural resources that generates more pollution and contributes to climate change. Indeed, many prominent economists now wonder if a global policy of free trade is causing more harm than good.

Globalization is an extraordinarily powerful and complex phenomenon with multiple sources, carriers, and impacts. Trade and technological change can substantially affect income distribution across types of workers and regions within countries. In general, openness favours workers, land, and capital capable of producing high-quality goods for export. It tends to worsen the lot of individuals and regions that produce goods and services competing closely with imports, inward FDI, and immigrants. In many countries in both the developed and developing world,

these impacts seem to make the distribution of income more unequal over time.

1.1.10 Globalization and International Business

Globalization has profoundly impacted international business by fostering an interconnected and interdependent global economy. It has removed trade barriers, reduced tariffs, and eased restrictions, allowing companies to operate beyond their domestic markets. This expansion has led to the growth of multinational corporations, which leverage global supply chains to produce and distribute goods and services efficiently across borders. As businesses tap into diverse markets, they gain access to a larger customer base, driving revenue growth and enhancing competitiveness. The integration of economies also encourages the exchange of ideas, technologies, and best practices, fostering innovation and improving overall business efficiency. Globalization has increased the complexity and dynamism of international business. Companies must navigate different regulatory environments, cultural nuances, and economic conditions. To succeed, businesses need to adopt strategies that are flexible and responsive to these varying factors. This includes understanding local consumer preferences, adhering to international trade laws, and managing geopolitical risks. Furthermore, the rise of digital technologies and e-commerce has accelerated globalization, enabling even small and medium-sized enterprises to enter the global market. Consequently, globalization not only provides opportunities for growth and expansion but also challenges businesses to continuously adapt and innovate in a rapidly changing global landscape.

◆ Interconnectedness

The following are the stages, approaches, and modes of operation in international business.

1.1.11 Stages of Internationalization of Business

The internationalization of business can be explained as going through five stages

◆ Domestic Focus

Stage - 1: Domestic Company

Domestic company limits their operations, mission, and vision to the national political boundaries. This company focuses its views on domestic market opportunities, domestic suppliers, domestic financial companies, domestic customers, etc. These companies analyze the national environment of the country and formulate strategies to exploit the opportunities offered by the environment. If the domestic company grows beyond its present capacity, the company will select a diversification strategy to enter into new markets, new products, technology, etc.

Stage - 2: International Company

Some domestic companies that grow beyond their production and/or domestic marketing capacities think of internationalizing their operations. Companies that decide to exploit the opportunities outside the domestic country are stage two companies. These companies believe that the practices adopted in domestic business, as well as the people and products of domestic business, are superior to those of other countries. These companies focus on domestic, but they extend their wings to foreign countries. These companies select the strategy of locating a branch in foreign markets and extending 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.

- ◆ Extension of domestic operations to foreign markets

Stage - 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. 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 a multinational company is also referred to as multi-domestic. The multi-domestic company formulates different strategies for different markets; thus, the orientation shifts from ethnocentric to polycentric.

- ◆ different strategies for different markets

Stage - 4: Global Company

A global company is one that has either a global marketing strategy or a global strategy. The global company either produces in their home country or 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 heavyweight motorcycles in the USA and markets in the global market.

Global strategy

Stage - 5: Transnational Company

The transnational company produces markets, invests and operates across the world. It is an integrated global enterprise that links global resources with global markets at a profit. There is no pure transnational corporation. However, most transnational companies satisfy many of the characteristics of a global corporation.

- ◆ integrated global enterprise

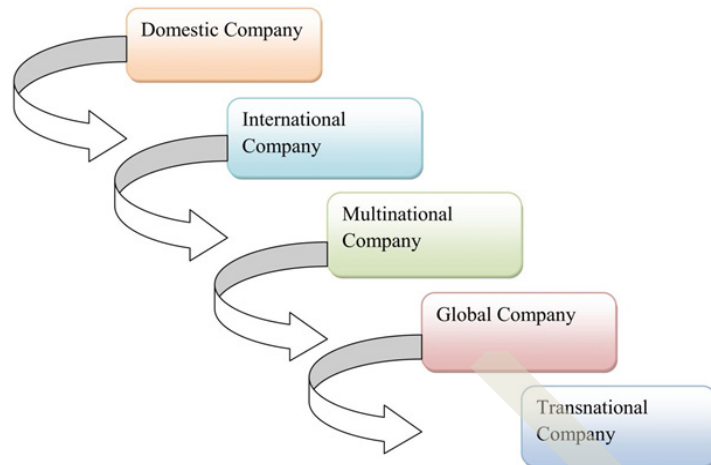


Figure 1.1.1: Stages of International Business
 (Source: http://www.simplynotes.in/wp-content/uploads/2016/03/stages_001.jpg)

1.1.12 International Business Approaches

International business approaches are similar to the stages of internationalization or globalization. Douglas Wind and Perlmutter advocate four approaches to international business. They are:

- a. Ethnocentric Approach
- b. Polycentric Approach
- c. Regio Centric Approach
- d. Geocentric Approach.

1.1.12.1 Ethnocentric Approach

Domestic companies normally formulate their strategies, their product design, and their operations toward the national markets, customers, and competitors. However, excessive production is more than the demand for the product, either due to competition or changes in customer preferences, which pushes the company to export excessive production to foreign countries. The domestic company continues exporting to foreign countries and views the foreign markets as an extension of 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 using this approach.

◆ Export Focus

Thus, maintaining the domestic approach towards international business is called the ethnocentric approach. This approach is suitable for companies during the early days of internationalization and also for smaller companies.

1.1.12.2 Polycentric Approach

Domestic companies that export to foreign countries using the ethnocentric approach find that, at a later stage, foreign markets need an altogether different approach. Then, the company establishes a foreign subsidiary company that decentralizes all the operations and delegates decision-making and policy-making authority to its executives. The company appoints executives and personnel, including a chief executive who reports directly to the company's managing director. The company appoints key personnel from the home country, filling all other vacancies with people from the host country. The executives of the subsidiary formulate the policies and strategies and design the product based on the host country's environment (culture, customs, laws, government policies, etc.), as well as the preferences of the local customers. Thus, the polycentric approach mostly focuses on the conditions of the host country in policy formulation, strategy implementation and operations.

- ◆ Host country adaptation on policy making

1.1.12.3 Regio-centric 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, the Asian environment, such as laws, culture, policies, etc.) for formulating policies and strategies. However, it markets more or less the same product designed under the polycentric approach in other countries of the region but with different market strategies.

- ◆ Regional Strategy

1.1.12.4 Geocentric Approach

Under this approach, the entire world is just like a single country for the company. They select employees from around the globe and operate with several subsidiaries. The headquarters coordinates 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.

- ◆ World, as a single market

Summarised Overview

Global business involves commercial activities that cross international borders, including trade, investments, and transactions between countries, primarily aimed at expanding market reach and increasing profitability. It is characterized by diverse cultural environments, complex legal frameworks, and logistics in global business allowing companies to access new markets, diversify revenue streams, leverage economies of scale, foster innovation, promote economic growth, and build international relationships. Key drivers include technological advancements, trade policy liberalization, and the pursuit of new markets and resources, with scope extending across various sectors and activities like exporting, importing, foreign direct investment, and global sourcing. Domestic business operates within a single country's borders, facing one set of regulations, culture, and economic conditions, while global business navigates multiple legal systems, cultural differences, and varying economic environments, managing foreign exchange risks and adapting products to local standards. Globalization refers to the increasing interconnectedness and interdependence of global markets, driven by technology, trade liberalization, and investment flows, facilitating international business by reducing barriers and enhancing market access.

Self-Assessment Question

1. What is international trade?
2. Describe the salient features of international trade.
3. What are the differences between internal trade and international trade?
4. What are the advantages and disadvantages of international trade?
5. Explain the impact of globalization.
6. Define global business and explain how it differs from domestic business.
7. Discuss the significance of global business in fostering innovation and economic growth.
8. Identify and elaborate on the key drivers of global business. How do these drivers influence the scope of international business operations?

Assignments

1. Explain the Problem faced by international business.
2. Elaborate the forms of international business
3. What do you mean by international business? State the differences between global business and domestic business



4. Write an essay discussing the significance of global business in today's economy. Highlight the benefits such as job creation, technology transfer, and economic development.

Suggested Reading

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5. Dasgupta, S., Laplante, B., Wang, H., & Wheeler, D. (2002). Confronting the environmental Kuznets curve. *Journal of Economic Perspectives*, 16, 146-168.
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5. Reddy, P. (1997). New trends in globalization of corporate R&D and implications for innovation capability in host countries: A survey from India. *World Development*, 25(11), 1821-1837.
6. Harrod, R. (n.d.). *International Economics*, p. 6.
7. Kindleberger, C. P. (n.d.). *International Economics*, p. 9.

Space for Learner Engagement for Objective Questions

Learners are encouraged to develop objective questions based on the content in the paragraph as a sign of their comprehension of the content. The Learners may reflect on the recap bullets and relate their understanding with the narrative in order to frame objective questions from the given text. The University expects that 1 - 2 questions are developed for each paragraph. The space given below can be used for listing the questions.

SGOU



Unit 2

Mode Of Entry

Learning Outcomes

After the completion of the unit, the learner shall be able to:

- ◆ identify the fundamental choices a company must make while entering the global market
- ◆ recognize the way to break into a foreign market
- ◆ explain the advantages and disadvantages of international franchising

Background

The growing field of international business has led to a lot of research on how companies enter foreign markets. This focus is important because the entry method chosen can make or break a company's success abroad. Companies must consider many factors when choosing their entry strategy. Risk tolerance is crucial; some companies prefer low-risk options like indirect exporting, while others take bigger risks by establishing wholly-owned subsidiaries. The desired level of control over operations also matters. Exporting offers limited control, whereas wholly-owned subsidiaries offer maximum control. Resource availability is another factor. Companies with limited resources might choose less capital-intensive methods like licensing and partnering with local firms to use their expertise and infrastructure. Scholars have studied various entry modes, including exporting (direct and indirect), joint ventures, licensing agreements, and foreign direct investment (FDI) through wholly-owned subsidiaries. Exporting, the most traditional method, involves selling domestically produced goods or services to foreign buyers. This method offers a low-risk entry point but limited control over marketing and distribution. Indirect exporting, where a middleman manages logistics and foreign market navigation, has even lower risk but reduced profit margins. By understanding these entry modes and the factors influencing their selection, companies can make informed decisions about their international expansion, ensuring long-term success in the global market.

Keywords

Mode of entry, Licensing, Franchising, Joint Venture, Strategic Alliance, Mergers and Acquisition, Contract Manufacturing, Counter Trade

Discussion

Businesses must first determine each market's potential for long-term profit. The most advantageous markets for any company include developed and developing countries with free market systems, stable political environments, low rates of inflation, and low levels of private sector debt. Successful businesses typically provide goods that are not generally accessible on the market and that address unmet needs, they look for areas where there is unmet demand. Businesses that prominently join overseas markets undertake a crucial strategic commitment that modifies the competitive landscape and entails decisions that are irrevocable and have long-term effects. Small-scale entry, on the other hand, can be alluring since it gives the company limited exposure to a foreign market but enables it to learn about it beforehand. While there isn't a perfect answer here, there are choices that offer varying degrees of risk and reward. The absence of previous experience increases the liability of being a foreign corporation. The absence of previous foreign entrants whose experience can be useful guidance increases the liability of being a foreign company. However, there are a lot of possible long-term benefits to using this tactic. Significant first-mover benefits are gained by the early large-scale entrant, supporting its long-term dominance in that industry.

◆ Market Selection & Risk Assessment

1.2.1 Exporting

Exporting is typically the easiest way to enter an international market, and therefore most firms begin their international expansion using this model of entry. Exporting is the sale of products and services in foreign countries that are sourced from the home country. Exporting is a traditional and well-established method of reaching foreign markets. Since it does not require that the goods be produced in the target country, no investment in foreign production facilities is required. Most of the costs associated with exporting take the form of marketing expenses.

◆ Traditional entry

1. Direct exporting

Direct exporting means the sale of goods abroad without involving middlemen. In the case of direct exporting, a firm



itself undertakes to sell its products overseas and is responsible for dealing with foreign firms directly.

2. Indirect exporting

Indirect exporting means the sale of goods abroad through middlemen. Indirect exporting involves using the help of independent middlemen and sales intermediaries that take the responsibility of sending the products to foreign countries.

3. Co-operative exporting

Cooperative export involves collaborative agreements with other firms (export marketing groups) concerning the performance of exporting functions. It is done by entering an agreement with another foreign or local organization to use its distribution network and reach the foreign market without the associated risks that come with other entry modes.

4. Intra-Corporate Transfers

Intra-corporate transfers are the selling of products by a company to its affiliated company in the host country. The ICT program allows qualified employees to be transferred, temporarily, from one country to another.

5. Piggybacking

Piggybacking involves two non-competing companies working together to cross-sell the other's products or services in their home country. Although it is a low-risk method involving little capital, some companies may not be comfortable with this method as it involves a high degree of trust as well as allowing the partner company to take a large degree of control over how your product is marketed abroad.

6. Entrepot trade

Entrepot trade means importing goods to export them to other countries. For example, India imports certain commodities from European countries and exports them to Nepal and Bhutan. This type of trade is also known as re-exporting trade.

1.2.1.1 Factors to be Considered in Exporting

- ◆ Government policies like export policies, import policies, export financing, foreign exchange, etc.
- ◆ Marketing factors like image, distribution networks, responsiveness to the customer, customer awareness, and customer preferences.
- ◆ Logistical consideration: These factors include physical distribution costs, warehousing costs, packaging, transporting, inventory carrying costs, etc.

- ◆ Distribution issues: These include the distribution networks and networks of the host country's companies. Japanese companies like Sony, Minolta, and Hitachi rely on the distribution networks of their subsidiaries in the host country.

1.2.1.2 Export Intermediaries

- ◆ Export Management: Companies act as the export department of the exporting firm (its client). These companies act as commission agents for exports or they take title to the goods.
- ◆ Co-operative society: The domestic companies desire to export the goods from a cooperative society, which undertakes the exporting operations of its members.
- ◆ International Trading Company: The company is engaged in direct exporting and importing. It buys goods from domestic companies and exports them. Therefore, the companies can export their goods by selling them to international trading companies.
- ◆ Manufacturers' Agents: They work on a commission basis. They solicit domestic orders from foreign manufacturers.
- ◆ Manufacturers' export agents: These agents also work on a commission basis. They sell the domestic manufacturers' products in foreign markets and act as their foreign sales department.
- ◆ Export and Import Brokers: The bankers bridge the gap between exporters and importers and bring these two parties together.
- ◆ Foreign forwarders: Foreign forwarders help domestic manufacturers in exporting their goods by performing various functions like physical transportation of goods, arranging customs documents, and arranging transportation services.

1.2.2 International Licensing

International licensing is a cross-border agreement that permits organizations in the target country the rights to use the property of the licensor. This property is generally intangible and includes trademarks, patents, and production techniques. The licensee is required to pay a fee in exchange for the rights specified in the contract between the parties. Licensing is commonly chosen because of its low-risk low exposure to economic and political conditions, high return on investment, and is

- ◆ Cross border agreement



preferred by local governments. Licensing can reduce the potential profit of outright ownership, affect the image of the brand due to a lack of control over the licensee, and nurture a potential future competitor.

1.2.2.1 Basic Issues in International Licensing

Companies should consider various factors in deciding on licensing deals. Each international licensing is unique and has to be decided separately. However, there are certain common factors, which affect most of the international licenses. They are specifying the agreement's boundaries, determining the royalty, determining rights, privileges, and constraints, defining resolution methods, and specifying the duration of the contract.

- ◆ **Boundaries of the agreements:** The companies should clearly define the boundaries of agreements. They determine which rights and privileges are being conveyed in the agreement.
- ◆ **Determination of royalty:** The most important factor in deciding the license is the amount of royalty. It is needless to mention that the licensor expects a high rate of royalty while the licensee would be unwilling to pay much royalty. However, both parties negotiate for a fair royalty for both sides to implement the contract more successfully.
- ◆ **Determining rights, privileges, and constraints:** Another important factor in granting a license is determining clearly and specifically the rights, privileges, and constraints.
- ◆ **Dispute settlement mechanism:** The licensee and licensor should mention the mechanism to settle the disputes as disputes are bound to crop up. This is because, the settlement of disputes in courts is costly, time-consuming, and hinders business interests.
- ◆ **Agreement duration:** The two parties of the agreement specify the duration of the agreement. Licensing cannot be a short-term strategy. Hence, the duration of the licensing should not be short-term. It would always be appropriate to have a long duration of the licensing.

Advantages

- ◆ Licensing mode carries relatively low investment on the part of the licensor.
- ◆ Licensing mode carries low financial risk to the licensor.
- ◆ Licensor can investigate the foreign market without much

effort on his part.

- Licensee gets benefits with less investment in research and development.
- Licensee escapes himself from the risk of product failure.

Disadvantages

- ◆ Both parties have responsibilities to maintain the product quality and promote the product. Therefore, one party can affect the other through improper acts.
- ◆ Costly and tedious litigation may crop up and hurt both the parties and the market.
- ◆ There is scope for misunderstanding between the parties despite the effectiveness of the agreement.
- ◆ There is a problem of leakage of the trade secrets of the licensor.
- ◆ The licensee may sell the product outside the agreed territory and even after the expiry of the contract.

1.2.3 International Franchising

Franchising is the practice of using another firm's successful business model. For the franchiser, the franchise is an alternative to building "chain stores" to distribute goods that avoid the investments and liability of a chain. The franchise offers the franchiser an option to create "chain stores" for the distribution of goods, avoiding the costs and liabilities associated with doing so. The prosperity of the franchisees determines the success of the franchiser. Since the franchisee has a direct investment in the company, it is stated that they are more motivated than direct employees. In terms of distribution, a franchiser is essentially a supplier who grants permission to an operator, also known as a franchisee, to use the supplier's brand and carry out the supplier's product distribution. The operator reimburses the supplier with a charge in return.

It is a system based on the licensing of the right to duplicate a successful business format in foreign markets. The franchisor grants the franchisee the exclusive power to distribute its products or services in establishments that are equivalently equipped and furnished, as well as the right to use Intellectual Property Rights (commercial signs, brands, trademarks, etc.). It also provides the Know-how (Franchise Handbook), and the technical and commercial support for distribution to be car-

◆ Alternative to chain stores



◆ legal rights

ried out correctly. The franchisee follows the instructions stated by the franchisor regarding the appearance, commercialization, and corporate image on the authorized premises. For the services provided, the franchisee pays the franchisor a series of different fees (sales fee, Front-end fee, advertising fee, etc.)

1.2.3.1 Franchising Agreements

The franchising agreement should contain important items as follows:

- ◆ The franchisee has to pay a fixed amount and royalty based on the sales to the franchisor.
- ◆ The franchisee should agree to adhere to the franchisor's requirements like appearance, financial reporting, operating procedures, customer service, etc.
- ◆ The franchisor helps the franchisee in establishing the manufacturing facilities, services facilities, providing expertise, advertising, corporate image, etc.
- ◆ The franchisor allows the franchisee some degree of flexibility to meet the local tastes and preferences. McDonald's restaurants in Germany sell beer also and McDonald's restaurants in France sell wine also.

Advantages

- ◆ Franchisors can enter global markets with low investment and low risks.
- ◆ The franchisor can get information regarding the markets, culture, customs, and environment of the host country.
- ◆ The franchisor learns more lessons from the experiences of the franchisees, which he could not experience in the home country's market.
- ◆ A franchisee can also start a business with low risk as he selects an established and proven product and operating system.
- ◆ Franchisee gets the benefits of R&D at low cost.
- ◆ Franchisee escapes from the risk of product failure.

Disadvantages

- ◆ International franchising may be more complicated than domestic franchising
- ◆ It is difficult to control the international franchisee.

- ◆ Franchising agents reduce the market opportunities for both the franchisor and the franchisee.
- ◆ Both parties have the responsibility to maintain product quality and product promotion.
- ◆ There is misunderstanding between the parties.
- ◆ There is a problem of leakage of trade secrets.

1.2.3.2. Difference between Franchising and Licensing

Basis	Franchising	Licensing
Governed by	Securities Law	Contract Law
Legislation	required	Not required
Territorial rights	Offered to franchisee	Not offered: licensee can sell similar licenses and products in the same area
Support and training	Provided by franchiser	Not provided
Royalty payments	Yes	Yes
Use of trademark/logo	Logo and trademark retained by franchiser and used by the franchisee	Can be licensed
Examples	McDonald's, Subway, Dunkin Donuts	Microsoft Office
Control	Franchiser exercises control over Franchisee	Licensor does not have control over licenses

1.2.4. Joint Ventures

A joint venture is a business agreement in which parties agree to develop a new entity and new assets by contributing equity. They exercise control over the enterprise and consequently share revenues, expenses, and assets. When two or

more persons come together to form a partnership to carry out a project, this is called a joint venture. In this scenario, both parties are equally invested in the project in terms of money, time, and effort to build on the original concept.

Since the cost of starting new projects is generally high, a joint venture allows both parties to share the burden of the project as well as the resulting profits.

Advantages

- ◆ Joint venture provides large capital funds.
- ◆ Joint ventures are suitable for major projects.
- ◆ Joint ventures spread the risk between or among partners.
- ◆ Different parties to the joint venture have different kinds of skills like technical skills, human skills, expertise, marketing skills, or marketing networks.
- ◆ Joint ventures make large projects and turnkey projects feasible and possible.
- ◆ Joint ventures provide synergy due to the combined efforts of varied parties.

Disadvantages

- ◆ Joint ventures also have the potential for conflicts. They result in disputes between or among parties due to varied interests.
- ◆ The partners delay the decision-making once a dispute arises. Then the operations become unresponsive and inefficient.
- ◆ Decision-making is normally slowed down in joint ventures due to the involvement of several parties.
- ◆ The possibility of the collapse of a joint venture is more due to the entry of competitors, changes in the business environment in the two countries, changes in the partners' strengths, etc.
- ◆ The life cycle of a joint venture is hindered by many causes of the collapse.

1.2.5 Strategic Alliance

Strategic alliances are agreements between two or more independent companies to cooperate in the manufacturing, development, or sale of products and services, or other business objectives. For example, in a strategic alliance, Company A and Company B combine their respective resources, capabilities,

◆ businesses pool resources

and core competencies to generate mutual interests in designing, manufacturing, or distributing goods or services. It is an arrangement between two companies to undertake a mutually beneficial project while each retains its independence. The agreement is less complex and less binding than a joint venture, in which two businesses pool resources to create a separate business entity. A company may enter into a strategic alliance to expand into a new market, improve its product line, or develop an edge over a competitor. The arrangement allows two businesses to work toward a common goal that will benefit both. The relationship may be short- or long-term and the agreement may be formal or informal.

1.2.6. Mergers and Acquisitions (M&A)

Mergers and Acquisitions (M&A) are defined as the consolidation of companies. Differentiating the two terms, Merger is the combination of two companies to form one, while Acquisition is one company taken over by the other. The reasoning behind M&A is that two separate companies together create more value compared to being on an individual stand.

- ◆ Mergers and acquisitions can take place:
- ◆ by purchasing assets
- ◆ by purchasing common shares
- ◆ by exchange of shares for assets
- ◆ by exchanging shares for shares

Types of Mergers

i. Horizontal Merger

A horizontal merger takes place when two companies, selling the same product or providing services to the same region, come together to enhance their reach. (Vodafone and Hutch, Disney + Hot Star)

ii. Vertical Merger

Vertical mergers happen between two companies producing different goods or services for a particular product or service. (eBay and PayPal) It may be either;

Backward Integration (Upstream)

Backward integration is a type of vertical integration that includes the purchase of or merger with, suppliers.

Forward integration (Downstream)

Forward integration is a form of vertical integration in

which a company moves further in the direction of controlling the distribution of its products or services.

iii. Concentric Merger

A concentric merger is when two businesses have the same customers in a specific industry, but they offer different products and services. For a merger to be considered concentric, the products or services must complement each other. An example of a concentric merger would be if a cell phone company merged with a cell phone case company.

iv. Reverse Merger

A reverse merger occurs when a private company acquires a public company to attain publicly-listed status. It's quicker to attain public firm status through a reverse merger.

v. Conglomerate Merger

A merger of companies that operate in completely different and unrelated industries. A pure conglomerate merger is between companies with totally nothing in common. A mixed conglomerate merger is between companies looking for a market or product extension. (L&T and Voltas).

1.2.7 Contract manufacturing

Contract manufacturing is a form of outsourcing where a company hires another company to produce parts, components, or entire products on its behalf. This practice allows the hiring company to focus on its core competencies, such as design, marketing, and sales, while leveraging the manufacturing expertise and capabilities of the contracted firm. Companies opt for contract manufacturing for various reasons, including cost reduction, increased production capacity, and access to specialized skills or technology that they do not possess in-house. By doing so, they can bring products to market more quickly and efficiently, while also maintaining flexibility in their operations. Contract manufacturing is prevalent across many industries, including electronics, pharmaceuticals, and consumer goods, where companies often need to scale production rapidly to meet market demands.

One of the primary benefits of contract manufacturing is cost efficiency. Setting up and maintaining a manufacturing facility can be prohibitively expensive, especially for small or medium-sized enterprises. Contract manufacturers often operate in regions with lower labour costs and have established supply chains that can source raw materials more cheaply. This cost advantage is passed on to the hiring company, allowing it to offer competitive pricing on its products. Additionally, contract manufacturers typically have specialized equipment and trained personnel that

◆ Outsourcing production

◆ Cost efficiency

can produce high-quality products at a faster rate than if the hiring company attempted to handle production itself. This not only saves money but also ensures that products meet stringent quality standards, which is crucial in industries like pharmaceuticals where regulatory compliance is mandatory.

Flexibility and innovation

Contract manufacturing provides companies with greater flexibility and the ability to innovate. By outsourcing production, companies can quickly respond to changes in market demand without the need to invest in additional infrastructure. This agility is particularly important in industries characterized by rapid technological advancements and shifting consumer preferences. For instance, in the electronics industry, product life cycles are short, and companies must continually innovate to stay competitive. Contract manufacturers can ramp up or scale down production as needed, allowing companies to manage inventory levels effectively and avoid the risk of overproduction. Furthermore, by partnering with contract manufacturers, companies can focus their resources on research and development, leading to the creation of new and improved products. This strategic approach enables companies to maintain a competitive edge in their respective markets while delivering high-quality products to consumers.

◆ Reciprocal form of international trade

1.2.8 Counter Trade

Countertrade is a reciprocal form of international trade in which goods or services are exchanged for other goods or services rather than for hard currency. This type of international trade is more common in developing countries with limited foreign exchange or credit facilities. Countertrade can be classified into three broad categories: barter, counter purchase, and offset. In any form, countertrade provides a mechanism for countries with limited access to liquid funds to exchange goods and services with other nations. Countertrade is part of an overall import and export strategy that ensures a country with limited domestic resources has access to required items and raw materials. Additionally, it provides the exporting nation with an opportunity to offer goods and services in a larger international market, promoting growth within its industries.

Examples of Countertrades

- ◆ A counter purchase refers to the sale of goods and services to a company in a foreign country by a company that promises to make a future purchase of a specific product from the same company in that country.
- ◆ A buyback is a countertrade that occurs when a firm builds a manufacturing facility in a country or supplies technolo-

gy, equipment, training, or other services to the country and agrees to take a certain percentage of the plant's output as partial payment for the contract.

- ◆ An offset is a countertrade agreement in which a company offsets a hard currency purchase of an unspecified product from that nation in the future.
- ◆ Compensation trade is a form of barter in which one of the flows is partly in goods and partly in hard currency.

1.2.9 Management Contracting

Under a management contract, one company provides another company with managerial expertise for a specified period. This may be in exchange for a lump-sum payment or a continuing fee on a percentage of sales value or volume. Sectors that commonly use management contracts are utility services and it may be possible in developing markets where they need assistance from developed markets. Management contracts may be useful entry modes where the home party has knowledge and expertise but cannot own the assets off-shore and the other party has a dependence or reason for management expertise.

◆ Management expertise

1.2.10 Turnkey Projects

In a turnkey project, a firm fully designs, constructs, and equips a production or service facility and is handed over to the purchaser upon completion. The project is handed over in such a ready and up-to-date state that the purchaser just has to “turn the key” to bring the facility to ignition. Turnkey projects are generally carried out as an agreement between one business belonging to a developed country and the other to a developing country. The former brings to the table advanced production technology, know-how, and economies of scale. This enables a business in a developing country to thrive and prosper with little assistance from the first-world countries. International turnkey projects include conceptualizing, designing, constructing, installing, and carrying out preliminary testing of manufacturing facilities or engineering projects at overseas locations for a client organization. It often includes providing training to the client's personnel to operate the plant.

◆ Complete solution

1.2.11 Greenfield Investment Strategy (Fdi Without Alliance)

A green-field investment is a type of foreign direct investment (FDI) in which a parent company creates a subsidiary in a different country, building its operations from the ground up. A Greenfield project is where the entire project has to start from scratch. And everything from planning to implementation is new.

◆ start from scratch

To overcome entry barriers, the Greenfield Investment Strategy (GIS) is used by big firms to get access to potential foreign markets. Therefore, a Greenfield Investment Strategy is getting/investing Foreign Direct Investment (FDI) in the target country. Under this, the investing company establishes a new operating facility or expands its existing facility in a foreign country. Here the word Green resembles an altogether 'New' investment. This type of FDI investment takes place when the parent company is unable to find prospective acquisition targets.

1.2.12 Brownfield Investment (Fdi With Strategic Alliance)

◆ invests in an existing facility

Brownfield investment (BI) is a type of foreign direct investment (FDI) where a company invests in an existing facility to start its operations in a foreign country. In other words, a Brownfield investment is the lease or purchase of a pre-existing facility in a foreign country. A Brownfield investment is often undertaken when a company wants to invest and start operations in a new country but does not want to incur the high start-up costs associated with a Greenfield investment. In a Brownfield investment, the company either invests in existing facilities and infrastructure through a merger and acquisition (M&A) deal or leases existing facilities in a foreign country.

1.2.13 International Leasing

◆ Beneficial to low-income countries

A firm can expand its business by leasing out new and used equipment to a manufacturing firm in such countries. The ownership of the property remains with the leasing firm (i.e., lessor) throughout the lease period during which the foreign-based user (i.e., lessee) pays the leasing fee. Leasing provides international business opportunities by rapid market access efficiently using idle and obsolete equipment. It also benefits low-income country-based manufacturers by reducing the cost of getting machinery and equipment from overseas and reducing investment and operational risks.

1.2.14 Foreign Portfolio Investment (FPI)

◆ buying foreign financial assets

Foreign portfolio investment refers to investments made in securities and other financial assets issued in another country. Portfolio investments typically have a shorter time frame for investment return than direct investments. As with any equity investment, foreign portfolio investors usually expect to quickly realize a profit on their investments. As securities are easily traded, the liquidity of portfolio investments makes them much easier to sell than direct investments. Portfolio investments are more accessible to the average investor than direct investments

because they require much less investment capital and research.

1.2.15 Forex Trade

♦ Trading in currencies

The term 'Forex' stands for Foreign Exchange. Forex trading is the trading in currencies from different countries against each other; for example, the US Dollar against the Euro. Even though the forex market is inevitable for international trade settlements, it can also be used as a mode to enter into international trade with distinctive strategies such as; Speculative business in forex, Arbitrage trade in forex, Hedging in forex, etc.

Summarised Overview

Licensing allows a company to grant another firm the right to produce its products or use its intellectual property in exchange for royalties, facilitating international expansion with minimal investment risk and maintaining control over key assets. Franchising enables businesses to grow rapidly by allowing franchisees to operate under their brand and system, providing a replicable model with reduced financial risk while ensuring consistency in standards and operations. Joint ventures involve the creation of a new entity by two or more companies to share resources, risks, and profits, offering access to new markets and technologies, but requiring careful management to navigate potential conflicts and align objectives. Strategic alliances are partnerships where companies collaborate on specific projects while remaining independent, enhancing capabilities and market reach without full integration, but needing clear agreements to manage roles and expectations. Mergers and acquisitions consolidate companies through financial transactions, enabling rapid growth and market entry, but they face challenges in integration, cultural alignment, and potential regulatory hurdles. Contract manufacturing outsources production to third-party manufacturers, reducing costs and allowing companies to focus on core activities, though it risks quality control and dependency on the manufacturer. Counter trade, including barter and counter-purchase, allows international trade without currency exchange, beneficial in financially constrained markets but complex to negotiate and implement, often requiring significant coordination and trust between trading partners.

Self-Assessment Question

1. What are the five common international entry modes?
2. What are the advantages of exporting?
3. What is the difference between a strategic alliance and an acquisition?
4. What would influence a firm's choice of the five entry modes?
5. What is the possible relationship among the different entry modes?
6. Describe strategic allegiance and counter trade
7. What do you mean by Turnkey projects?

Assignments

1. Write a detailed report on the advantages and disadvantages of international licensing agreements for both licensors and licensees.
2. Discuss the benefits and challenges faced by both franchisors and franchisees
3. Compare and contrast at least two joint venture situations, emphasising what made each successful or failed.
4. Analyze the impact of a recent major merger or acquisition on the involved companies' market position and financial performance.

Suggested Reading

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7. Kindleberger, C. P. (n.d.). *International Economics*, p. 9.

Space for Learner Engagement for Objective Questions

Learners are encouraged to develop objective questions based on the content in the paragraph as a sign of their comprehension of the content. The Learners may reflect on the recap bullets and relate their understanding with the narrative in order to frame objective questions from the given text. The University expects that 1 - 2 questions are developed for each paragraph. The space given below can be used for listing the questions.

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02 BLOCK

Theoretical Foundations of Global Business

Block Content

Unit - 1 International Business Environment

Unit - 2 International Trade Theories

Unit 1

International Business Environment

Learning Outcomes

After the completion of this unit, the learner will be able to:

- ◆ understand the meaning and scope of International Business Environment
- ◆ be familiarise with the different components of the international business environment
- ◆ understand the political environment and its implications on international business
- ◆ ascertain the legal practices in different countries

Background

The International Business Environment is a complex, multifaceted landscape shaped by the interplay of economic, political, social, technological, environmental, and legal factors across different countries and regions. It encompasses the global marketplace where businesses operate and compete, driven by the forces of globalisation, which have facilitated increased interdependence and integration of national economies. Economic factors include variations in economic development, currency exchange rates, and international trade policies, influencing market dynamics and investment opportunities. Political stability, government policies, and regulatory frameworks significantly impact business operations, with international relations and geopolitical tensions adding layers of complexity. Social and cultural dimensions, such as demographic trends, consumer preferences, and cultural norms, affect marketing strategies and product adaptations. Technological advancements and innovations drive competitiveness, enabling businesses to optimize operations, expand their reach, and enhance customer experiences. Environmental considerations, including sustainability practices and climate change policies, are increasingly crucial as businesses strive to balance profitability with ecological responsibility. Legal factors, encompassing international laws, trade agreements, intellectual property rights, and labour regulations, govern the conduct of international business, ensuring compliance and ethical practices. The international business environment is dynamic and constantly evolving, requiring businesses to be agile, adaptive, and informed to navigate the challenges and seize the opportunities presented by global markets. In this context, multinational corporations, small and medium-sized enterprises, and startups must develop robust

strategies that account for the diverse and interconnected elements influencing their operations. Understanding the international business environment is essential for success, as it enables companies to anticipate changes, mitigate risks, and capitalise on emerging trends, ultimately fostering sustainable growth and competitive advantage in the global arena

Keywords

Business Environment, Legal, political, technological, Socio-cultural environment, PEST analysis

Discussions

Introduction

A multinational company has to formulate strategies based on its missions, visions, objectives, and goals. Strategy formulation is a must for a global company to make decisions regarding the markets to enter, and the product/service range to be introduced in the foreign countries. The fundamental basis for strategy formulation is environmental analysis. The environment provides opportunities for the business to produce and sell a particular product. Environment sometimes poses threats and challenges to business. Businesses should enhance their strengths to face the challenges posed by the environment. Scanning the environment helps the business to formulate strategies and run the business efficiently in the competitive global markets.

2.1.1 Meaning of International Business Environment

It is those factors/activities that surround/encircle the international business. In other words, business environment means factors that affect or influence MNCs and transnational companies. An international business environment refers to the surroundings in which international companies run their businesses. Therefore, the people at the managerial level must work on the factors that comprise of International Business Environment. The (IBE) International Business Environment is multidimensional as it involves various things like political risks, cultural differences, exchange risks, and legal & and taxation issues. Therefore (IBE) International Business Environment is crucial for a country's economy. It plays a pivotal role in the growth and development of the country.

- ◆ Surroundings of international trade practices

◆ Internal and external environmental factors

Business environmental factors are broadly divided into internal environmental factors and external environmental factors. Internal environmental factors include human resource management, trade unions, organization structure, financial management, marketing management production management /leadership style, etc. External environmental factors are further divided into micro and macro external environmental factors. Micro-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.

2.1.2 Features of International Business Environment

Since business operations are performed without any barriers, with the implementation of L.P.G (Liberalization, Privatization, Globalization) there is a boom in the global business and the trade barriers have been liberalized.

This has

- ◆ Attracted F.D.I (Foreign direct investment)
- ◆ Encouraged flexible import and export policies
- ◆ Given rise to import of jobs in the field of I.T enabled services BPO (Business Process Outsourcing)
- ◆ Caused increase in foreign currency reserves
- ◆ Improved standard of living
- ◆ Brought about increase in purchasing power
- ◆ Improved quality of goods and services

2.1.3 Significance of International Business Environment

Even though the firms have to undergo a lot of problems while expanding their business internationally, still international business brings countries closer. This process makes the world a global village and creates an atmosphere of unity. It exchanges ideas, information, service, and capital across the country's borders.

This has encouraging outcomes in terms of the greatest use of human capital that enlarges employee opportunity in the

◆ Global village



global market. There is equal growth of price stability, wealth, and availability of goods & services to each and every one. It also brings a new environment of development, alliance, stability, affluence, modernisation, and technologies. Foreign markets create a larger share of the total business of a lot of firms that have wisely sophisticated markets aboard. The importance of IBE includes:

- ◆ Helps in earning Foreign Exchange
- ◆ Optimum utilization of resources
- ◆ Helps in spreading risks of the business.
- ◆ Improves efficiency of organizations and helps to achieve organizational objectives
- ◆ Helps to understand the different forces acting upon international business
- ◆ Helps to get benefits from governments.
- ◆ Increases the competitive advantage of businesses.
- ◆ Helps in expansion and modernisation.
- ◆ Helps in managing product life cycle.
- ◆ Technological competency of businesses can be improved.

2.1.4 Forces of International Environment

i. Internal Environmental Forces

Forces within the organization, which are controllable, like production, finance, marketing, human resources research and development, etc

ii. External Micro Environmental Forces

Forces outside the organization, which are controllable, like competitors, suppliers, creditors, consumers, financial institutions etc.

iii. External Macro Environmental Forces

Forces outside the organization, which are uncontrollable, like political environment, legal environment, technological environment, economic environment, cultural environment etc

2.1.5 Methods of Scanning International Business Environment

There are three ways of scanning the international business environment

◆ Controllable factors within the Organisation

◆ Controllable factors outside the Organisation

◆ Uncontrollable factors outside the organisation.

- ◆ **Ad-hoc scanning** - short-term, infrequent examinations usually initiated by a crisis
- ◆ **Regular scanning** - studies being done on a regular schedule (say, once a year)
- ◆ **Continuous scanning** - (also called continuous learning) - continuous structured data collection and processing on a broad range of environmental factors.

Most commentators feel that in today's turbulent business environment, the best scanning method available is continuous scanning. This allows the firm to act quickly, take advantage of opportunities before competitors do, and respond to environmental threats before significant damage is done.

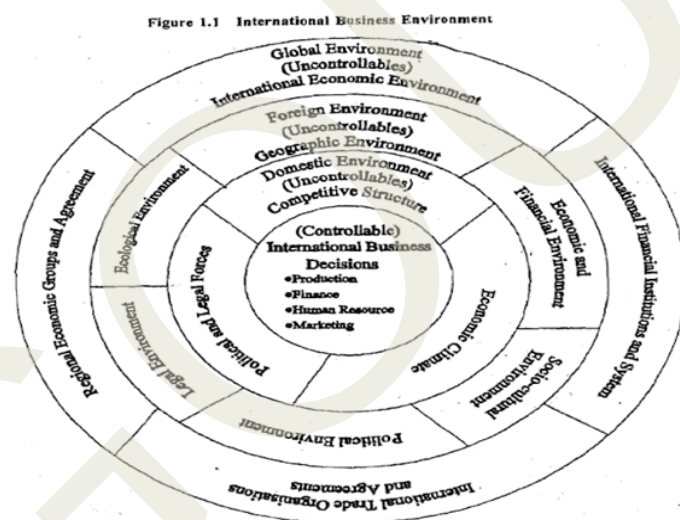


Figure 2.1.1: International Business Environment

2.1.6 Components of The International Business Environment

The components of the IBE consists of

- Economic environment
- Political environment
- Legal environment
- Social environmet
- Cultural environmet
- Technological environment.

A detailed explanation of IBE are as follows

2.1.7 Economic Environment

Economic environment refers to all those economic factors which have a bearing on the functioning of a business unit. The

- ◆ Link between domestic and foreign country

economic environment of various countries directly influences international business operations. In fact, the international economic environment and global business interact with each other.

The major features include:

- ◆ Capital flow rather than trade or product flow across the globe.
- ◆ Establishment of production facilities in various countries.
- ◆ Technological revolutions link the relations between the size of the production and level of employment.
- ◆ The macroeconomic factors of individual nations independently do not significantly control the global economies.

Economic system

The economic system is one of the important factors of economic development that influences international business to a great extent. The economic system is an organization of institutions established to satisfy human needs or wants of the economy.

There are three types of economic systems:

- ◆ Capitalistic Economic System
- ◆ Socialist Economic System
- ◆ Mixed Economic System

Capitalistic Economic System

This system provides for economic democracy and customer choice for products or services. This system emphasizes the philosophy of individualism, believing in private ownership of production and distribution facilities Ex: USA, Japan, UK.

Socialist Economic System

Under this system, private properties and property rights are abolished. The State owns all the factors of production and distribution but the major limitation of this system is to reduce the individual freedom of choice; and it has failed to achieve significant economic growth.

Eg; China, Cuba, Vietnam

Mixed Economic System

Under this system, major factors of production and distribution are owned, managed and controlled by the State. The purpose is to provide benefits to the public more or less on an

equal basis. This system does not distribute the existing wealth equally among people but believes in full employment and suitable rewards for the worker's efforts. Ex: India, Bangladesh, Sri Lanka

Income wise classification of Countries

Low-Income Countries

These countries are also known as third world countries or pre-industrial countries. The characteristics include a high birth rate, low literacy rate, political instability and unrest, technological backwardness, underutilization of natural resources, excessive unemployment and underemployment, and excessive dependency on imports.

Lower Middle-Income Countries

These countries are known as less developed countries. The characteristics of these countries include – the early stage of industrialization, expansion of consumer market, availability of cheap and motivated human resources, location for the production of standardized products or exporting, ex: clothing for exports.

Upper Middle-Income Countries

These countries are called industrializing countries. The characteristics of these countries are – less dependency on agriculture, high exports, increase in literacy, formal education, rapid economic development, occupation mobility of people from agriculture to industry, and increased wage rate.

High-Income Countries

These countries are known as advanced countries, industrialized, post-industrialized, or first-world countries. The characteristics include – the development of the information sector, emphasis on the future plans, development of intellectual technology over machine technology and it aims at building an information society.

2.1.7.1 Impact of Economic Environment on International Business

i. Economic Growth

The business helps for the identification of peoples' needs and wants for the production of goods and services and supply to the people. Thus, it creates the conversion of inputs into outputs and enables consumption. It leads to economic development. The high economic growth rate of the countries provides an opportunity of expanding market shares to international business firms.



ii. Inflation

It is an important factor that affects the market share of an international business firm. It affects the interest rate as the demand for money is high due to the higher prices and it also affects the exchange rate of the domestic currency in terms of various foreign currencies.

iii. Balance of Payments (BoP)

The balance of Payments position of a country is an outcome of international business and also affects the future of international business. Export and import trade in goods and services affect the current accounts position and the flow of capital affects the capital accounts position.

iv. Economic Transition

The process of liberalization has provided significant opportunities to MNCs to enter most of the countries of the world either by locating their manufacturing facilities or by expanding or both. Thus, MNCs are the immediate and greatest beneficiaries of Liberalization, Privatization and Globalization of world economies.

2.1.8 Political Environment

◆ Political System prevailing in a country

The influence of the political environment on business is enormous. The political system prevailing in a country promotes, decides, encourages, directs, and controls the business activities of that country. PE includes factors such as the characteristics and policies of political parties, the nature of the constitution and Government system, and the Government environment influencing the economic and business policies and regulations.

2.1.8.1 Factors Influencing Political Environment

i. Political ideology

Political ideology is the body of complex ideas, theories and objectives that constitute a sociopolitical program. Political ideologies of the people in the same country vary widely due to the variations in culture, ethnic group, community groups, and religious and economic groups. These variations influence the people to form different political parties. The difference in political ideologies changes the national boundaries.

ii. Democracy

It refers to a political arrangement in which the supreme power is vested in the hand of the people.

iii. Political rights and Civil liberties

It helps in evaluating the freedom of citizens. The major indicators of political liberties

Include:

- ◆ conduct of elections fairly and competitively
- ◆ power and ability of the voters in casting their votes in the process of electing
- ◆ people's ability in forming political parties and groups.

iv. Political Relations

A political friendly relationship results in the growth of bi-lateral or multi-lateral trade. Eg: the friendly relationship between India and USA helped the Pakistan companies to have a close business linkage with India

v. Political System

Appraisal of the political system helps us in having ideas of the political system and its impact on international business. They are classified as, two-party systems, multiparty systems, and single-party systems. In two-party systems, the two parties take a turn in controlling the Government. In a multiparty system, there are many parties and no party is strong to gain the control of the Government: Ex: Germany, France and India. In Single party system, only one dominant party gets the opportunity to control the Government even though several parties exist.

Changes in political policies and regulations have significant exposure to the business. For example:

- i. **Antitrust or competition rules** govern business enterprises and promote competition for the benefit of consumers.
- ii. **Labor regulations** govern worker-employers relations. They could consist of minimum wages, discriminatory practices, work requirements, occupational health and safety, and dismissal.
- iii. **Data protection laws** governing the management of personal information.
- iv. **Environmental law** covers legal aspects concerning how businesses should operate an environmentally friendly way.
- v. **Tax policies (tax rates and incentives)** regulate mandatory levies on individuals or entities by the government.
- vi. **Trade policies** such as tariffs, import quotas, and administrative procedures related to export-import.



- vii. Intellectual property laws** regulate the protection of copyright, patents, and other intellectual property protection.
- viii. Subsidy policies**, both business and individual, such as export subsidies and education subsidies.
- viii. Corporate governance policies** to ensure that companies operate transparently and ethically to promote ethical business practices.

2.1.9 Legal Environment

Firms operating internationally face major challenges in conforming to different laws, regulations, and legal systems in different countries. The legal framework to protect small and medium enterprises (SMEs), mainly to achieve social objectives, adversely influences the expansion of manufacturing capacities and achieving economies of scale in certain countries. International managers need to develop a basic understanding of the types of legal systems followed in the countries of their operations before entering into legal contracts. The independence of a country's judicial system from the political influences of the members of governments, citizens, or firms is crucial for the fair treatment a firm receives in its overseas operations. A fair judicial system also reduces political risks in overseas markets. The level of judicial independence and efficiency differs widely among countries.

◆ Laws and Regulation

2.1.9.1 Legal Systems in International Business

i. Common Law

It is based on traditions, past practices, and legal precedents set by the courts through interpretation of statutes, legal legislation, and past rulings. It depends less on written statutes and codes. Common law originated from England and it is followed in most of the former British colonies, such as India, the US, Canada, Australia, and New Zealand.

ii. Civil Law

Also known as code or civil law, it is based on a comprehensive set of written statutes. It is derived from the Roman law and is followed in most of continental Europe, Japan, and Latin America. The elaborate legislative codes embody the main rules of the law, spelling out every circumstance. Laws of most countries have elements of both common and civil law. The complications in a meeting out of non-performance of a business contract also vary widely among the common- and civil-law countries.

iii. Socialistic Law

This law is derived from the Marxist socialist system and continues to influence the legal framework in former communist countries, such as the China, North Korea, Vietnam, and Cuba. Socialist law traditionally advocates ownership of most property by the state or state-owned public enterprises, prohibiting free entry to foreign firms.

2.1.9.2 Principles of International Law

i. Principle of Sovereignty

A 'sovereign' state is independent and free from all external control and enjoys complete legal equality with other states. It governs its own territory, has the right to select and implement its own political, economic, and social systems and has the power to enter into bilateral or multilateral agreements with other nations. Thus, a sovereign state exercises powers over its own members and in relation to other countries. This also implies that the courts of a sovereign country cannot be used to rectify its injustices against other countries.

ii. International Jurisdiction

Under international law, there are three basic types of jurisdictional principles such as nationality principles, territoriality principles, and protective principles. Every country has jurisdiction over its citizens, irrespective of their locations. For instance, an Indian citizen traveling abroad may be given a penalty by a court in India. These are the Nationality principles. The territoriality principle is the right of jurisdiction within its own legal territory. Therefore, a foreign firm involved in illegal business practices in India can be sued under Indian law. Every nation has jurisdiction over conduct that adversely affects its national security even if such behaviour occurs outside the country. These are protective principles. For instance, an Italian firm that sells India's defense secrets can be booked under the Indian law.

iii. Treatment and Rights of Aliens

Nations have the right to impose a restriction upon foreign citizens on their rights to travel and stay, their conduct, or area of business operations. A country may also refuse entry to foreign citizens or restrict their travel. As a result of rising terrorism during the last decade, the US and many European countries have imposed restrictions on foreigners.

iv. Forum for Hearing and Settling Disputes

Courts can dismiss cases at their discretion, brought before them by foreigners. However, courts are bound to examine issues, such as the place from where evidence must be collected,



the location of the property under restitution, and the plaintiff. For instance, after the disaster of Union Carbide's pesticide plant located at Bhopal in India, the New York Court of Appeals sent back the case to India for resolution.

2.1.10 Social Environment

It consists of religious aspects, language, customs, traditions, tastes and preferences, living habits, dressing habits, etc. It also influences the level of consumption. Example: The economic position of Germans and French people is more or less the same, culturally different. So, the study of the social environment helps in deciding the type of market, product, etc.

The various factors of social environment effect on international business are:

i. Religion

Religion is one of the important social institutions that influence the business. Religions play a vital role in normal and ethical standards in production and marketing of goods and services.

ii. Behavioural factors affecting the business

Human behavior affects the business including employee behavior, consumer behavior, and behavior of stakeholders (Holders of debentures, bonds, etc.) Cultural differences in various countries result in variations in human behavior from country to country. Businesses should consider behavior patterns of social groups in hiring, marketing, and selecting suppliers of inputs and market intermediaries.

iii. Motivations and Achievements

The economic development of a country depends on the motivation of people to work hard and the desire for achievement. People rank their 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.

iv. Individualism V/s Collectivism

Individualism and collectivism are consequences of the culture and affect the formation of groups, productivity, and marketing practices.

v. Risk-taking behavior

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. Employees in countries with

low scores of uncertainty avoidance prefer flexible organization and flexible work.

2.1.11 Cultural Environment

Culture is, “the thought and behavior patterns that a member of society learns through language and other forms of symbolic interaction – their customs, habits, beliefs and values, the common viewpoints which bind them together as a social entity. Cultural change gradually picks up new ideas and drops 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.”

2.1.11.1 Features of Cultural Environment

- ◆ Culture is derived from the climatic conditions of the geographical region and economic conditions of the country.
- ◆ It is a set of traditional beliefs and values which are transmitted and shared in a given society.
- ◆ It is a total way of life and thinking patterns that are passed from generation to generation.
- ◆ It is norms, customs, art, values, etc.
- ◆ It prescribes the kind of behavior considered acceptable in society.
- ◆ Culture is not immune to change. It goes on changing
- ◆ Culture is acquired through learning but not inherited genetically.
- ◆ It is based on social interaction and creation.

2.1.11.2 Cultural Factors Influencing International Business

i. Cultural Universal

Irrespective of religion, race, region, caste, etc, all of us have more or less the same needs. These common needs are referred to as “Cultural Universal”. The cultural Universal enable the businessmen to market the products in many foreign countries with modifications. Example: TV’s, cars, video games.

ii. Languages

Language is the basic medium of communication. There are more than 5000 spoken languages in the world. The same words in the same language may mean different things in the different regions of the country.



iii. Cultural attitude and International Business

Dressing habits, living styles, eating habits, and other consumption patterns and the priority of needs are influenced by culture..

iv. Space and Culture

Space between one person and another person plays a significant role in communication. But culture determines the pace/distance between one person and another person. Americans need more distance from a third person for privacy. This is unimportant for Indians.

2.1.12 Technological Environment

Technology is the application of knowledge. In other words, technology has a systematic application of scientific or other organized knowledge to a particular task. It brings changes to society, the economy, and politics. Technology impacts international business and even the entire globe.

2.1.12.1 Dimensions of Technology in International Business

i. Investments in technology

Advanced countries spend a considerable amount on research and development for further advancement of technology.

ii. Technology and economic development

Technology is one of the significant factors, that determines the level of economic development of a country. The differences between nations are mostly reflected by the level of technology.

iii. Technology and International competition

A few companies invent but many companies adopt scientific knowledge to generate wealth by application and communication. The invention process and global competitiveness are the two determinants of a national wealth.

iv. Technology Transfer

Technology and global business are interdependent. International business spread technology from advanced countries to developing countries by establishing the subsidiaries or establishing the subsidiary's joint ventures with the host countries and arranging technological transfer to the company of developing countries through technological alliances.

v. Technology and location of plants

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

advantages of cheap labour.

vi. Scanning of Technological environment

The level of technology is not the same in all the countries. Advanced countries enjoy the latest technology while the developing nations face the consequences of outdated technology. Therefore, MNCs have to understand technology and analyze it before entering foreign market.

vii. Technology and globalization

The industrial revolution resulted in large scale production and the recent technological revolutions has led to the production of high-quality products at a lower cost. These factors force the domestic company to enter the foreign countries in order to find market for their products. Thus, technology is one important cause for globalization.

2.1.13 Tools for Environmental Analysis

Environmental analysis is the process of evaluating the environmental impact of a project, product, or service. There are a number of tools that can be used to conduct an environmental analysis, depending on the specific needs of the project. Here are some of the most common tools:

- ◆ **Checklist:** A checklist is a simple tool that can be used to identify potential environmental impacts. Checklists can be tailored to specific types of projects or activities.
- ◆ **Matrix:** A matrix is a more complex tool that can be used to identify and evaluate the potential environmental impacts of a project. Matrices typically consider the severity of the impact, the likelihood of the impact occurring, and the importance of the environmental factor that is being impacted.
- ◆ **Geographic Information Systems (GIS):** GIS is a computer system that can be used to store, analyze, and display geographic data. GIS can be used to identify environmental factors that may be impacted by a project, such as wetlands, endangered species habitat, and floodplains.
- ◆ **Life Cycle Assessment (LCA):** LCA is a method for assessing the environmental impact of a product or service throughout its entire life cycle, from the extraction of raw materials to the disposal of the product at the end of its useful life.
- ◆ **Environmental Impact Statement (EIS):** An EIS is a detailed document that is required by law for certain types of projects that have the potential to have a significant impact

on the environment. EISs typically include a description of the proposed project, the alternatives to the proposed project, and the potential environmental impacts of the proposed project and the alternatives.

The choice of which tool to use will depend on the specific needs of the project. For example, a simple checklist may be sufficient for a small project with minimal environmental impact, while a more complex tool, such as an EIS, may be required for a large project with the potential for significant environmental impact.

2.1.14. Pest Analysis

PEST analysis stands for “Political, Economic, Social, and Technological analysis” and describes a framework of macro-environmental factors used in environmental scanning. It is also referred to as the STEP, STEEP, or PESTLE analysis (Political, Economic, Socio-cultural, Technological, Legal, and Environmental). Recently it was even further extended to STEEPLED, including Ethics and Demographics. It is a part of the external analysis while doing market research and gives a certain overview of the different macro-environmental factors that the company has to take into consideration. Political *factors* include areas such as tax policy, employment laws, environmental regulations, trade restrictions and tariffs and political stability. The economic factors are economic growth, interest rates, exchange rates and inflation rate. Social factors often look at the cultural aspects and include health consciousness, population growth rate, age distribution, career attitudes and emphasis on safety. The technological factors also include ecological and environmental aspects and can determine the barriers to entry, minimum efficient production level and influence outsourcing decisions. It looks at elements such as R&D activity, automation, technology incentives and the rate of technological change.

◆ Environmental Scanning Framework

The political factors include:

- ◆ Political climate - amount of government activity
- ◆ Political stability and risk
- ◆ Government debt
- ◆ Budget deficit or surplus
- ◆ Corporate and personal tax rates
- ◆ Payroll taxes
- ◆ Import tariffs and quotas

- ◆ Export restrictions
- ◆ Restrictions on international financial flows

The economic factors are:

- ◆ GNP or GDP per capita
- ◆ GNP or GDP growth
- ◆ Unemployment rate
- ◆ Inflation rate
- ◆ Consumer and investor confidence
- ◆ Inventory levels
- ◆ Currency exchange rates
- ◆ Merchandise trade balance
- ◆ Financial and political health of trading partners
- ◆ Balance of payments
- ◆ Future trends

The socio-cultural factors include

Demographic factors such as:

- ◆ Population size and distribution
- ◆ Age distribution
- ◆ Education levels
- ◆ Income levels
- ◆ Ethnic origins
- ◆ Religious affiliations

Attitudes towards:

- ◆ Materialism, capitalism, free enterprise
- ◆ Individualism, role of family, role of government, collectivism
- ◆ Role of church and religion
- ◆ Consumerism
- ◆ Environmentalism

- ◆ Importance of work, pride of accomplishment
- ◆ Diet and nutrition
- ◆ Housing conditions

The technological factors include

- ◆ Efficiency of infrastructure, including: roads, ports, airports, rolling stock, hospitals, education, healthcare, communication, etc.
- ◆ Industrial productivity
- ◆ New manufacturing processes
- ◆ New products and services of competitors
- ◆ New products and services of supply chain partners
- ◆ Any new technology that could impact the company
- ◆ Cost and accessibility of electrical power

2.1.15 Porter’s Five Forces Model

The tool was created by Harvard Business School professor Michael Porter, to analyze an industry’s attractiveness and its potential profitability. Since its publication in 1979, it has become one of the most popular and highly regarded business strategy tools. Porter recognized that organizations like to keep a close watch on their rivals, but, in his Harvard Business Review article, ‘How Competitive Forces Shape Strategy,’ he encouraged them to look beyond the actions of their competitors and examine the forces at work in their wider business environment. Porter’s Five Forces is a model that identifies and analyzes five competitive forces that shape every industry and helps determine an industry’s weaknesses and strengths. Five Forces analysis is frequently used to identify an industry’s structure to determine corporate strategy. Porter’s model can be applied to any segment of the economy to understand the level of competition within the industry and enhance a company’s long-term profitability.

◆ Determine Corporate Strategy

Porter’s five forces are:

1. Competition in the industry
2. Potential of new entrants into the industry
3. Power of suppliers
4. Power of customers
5. Threat of substitute products

2.1.15.1 Competition in the Industry

The first of the five forces refer to the number of competitors and their ability to undercut a company. The larger the number



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

2.1.15.2 Potential of New Entrants into an Industry

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

2.1.15.3 Power of Suppliers

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

2.1.15.4 Power of Customers

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

2.1.15.5 Threat of Substitutes

The last of the five forces focuses on substitutes. Substitute goods or services that can be used in place of a company's products or services pose a threat. Companies that produce goods or services for which there are no close substitutes will have more power to increase prices and lock in favorable terms.

Summarised Overview

The International Business Environment comprises various components, including the Economic Environment, Technological Environment, Political Environment, Legal Environment, and Socio-Cultural Environment. The Economic Environment involves factors like economic development levels, exchange rates, and trade policies that affect market dynamics and business opportunities. The technological environment encompasses advancements and innovations that drive competitiveness and operational efficiencies, allowing businesses to expand their reach and enhance customer experiences. The political environment includes government policies, political stability, and international relations that impact business operations and strategic decisions. The legal environment covers international laws, trade agreements, intellectual property rights, and labor regulations, ensuring compliance and ethical business practices. The socio-cultural environment involves demographic trends, consumer preferences, and cultural norms, influencing marketing strategies and product adaptations. Tools for Environmental Analysis, such as PEST Analysis and Porter's Five Forces model, help businesses assess external factors and competitive forces. PEST Analysis evaluates the Political, Economic, Social, and Technological factors affecting a business, providing a comprehensive overview of the macro-environment. Porter's Five Forces model analyzes the competitive forces within an industry, including the threat of new entrants, bargaining power of suppliers and buyers, threat of substitute products, and industry rivalry, enabling businesses to develop strategic insights and maintain competitive advantage.

Self-Assessment Question

1. Mention two main drivers of international business
2. What is joint venture?
3. Expand PEST analysis?
4. Name the five forces in Porter's Five Forces model.
5. What is contract manufacturing?
6. Name the two factors influencing political environment.
7. What are the approaches to international business?
8. Name the stages of internationalisation of a business.
9. What is a strategic alliance?
10. How do political and legal environments affect the international business environment of a business?

Assignments

1. Do you think Indian firms should go global? Why should not they remain content with domestic market, which is vast?
2. Explain different modes of entry into international business with the help of real-life examples.
3. Describe PEST Analysis with the help of suitable examples.
4. Why do firms enter international markets? How do the different kinds of environmental factors enable the domestic firms to go global?
5. What are the areas of concern for an MNC with regard to its legal environment?

Suggested Reading

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SGOU

Unit 2

International Trade Theories

Learning Outcomes

After completing this unit, the learner will be able to:

- ◆ explain the meaning and significance of international trade and its impact on global economies.
- ◆ gain knowledge of various international trade theories
- ◆ compare and contrast different theories of international trade and evaluate their relevance in the contemporary global market.

Background

International trade theories have evolved to explain the dynamics of global commerce, focusing on why nations trade, the benefits they derive, and the patterns of trade. Classical theories like mercantilism (16th-18th century) emphasized national wealth through a positive trade balance, advocating for export maximization and import minimization. Adam Smith's theory of absolute advantage (1776) argued for specialization in goods where a country is most efficient, while David Ricardo's comparative advantage (1817) extended this idea, showing that countries benefit from trade even if they lack an absolute advantage, by specializing in goods with the lowest opportunity costs. The Heckscher-Ohlin theory (1930s) introduced the idea that countries export goods using their abundant factors of production intensively and import those using scarce factors. Modern theories, such as Paul Krugman's New Trade Theory (1980s), highlight economies of scale and network effects, explaining intra-industry trade and the dominance of certain global industries. Michael Porter's Diamond Model (1990) focuses on national competitive advantage arising from factor conditions, demand conditions, related industries, and firm strategy. The Gravity Model of Trade posits that trade volumes are influenced by the economic sizes (GDP) of trading partners and their geographic proximity. Together, these theories provide a comprehensive understanding of international trade, guiding policymakers and economists in navigating the complexities of global markets.



Keywords

Mercantilism, Comparative cost advantage theory, Product life cycle theory, Heckscher-Ohlin theory

Discussion

International trade theories have evolved to explain the dynamics of global commerce, focusing on why nations trade, the benefits they derive, and the patterns of trade. Classical theories like mercantilism (16th-18th century) emphasized national wealth through a positive trade balance, advocating for export maximization and import minimization. Adam Smith's theory of absolute advantage (1776) argued for specialization in goods where a country is most efficient, while David Ricardo's comparative advantage (1817) extended this idea, showing that countries benefit from trade even if they lack an absolute advantage, by specializing in goods with the lowest opportunity costs. The Heckscher-Ohlin theory (1930s) introduced the idea that countries export goods using their abundant factors of production intensively and import those using scarce factors. Modern theories, such as Paul Krugman's New Trade Theory (1980s), highlight economies of scale and network effects, explaining intra-industry trade and the dominance of certain global industries. Michael Porter's Diamond Model (1990) focuses on national competitive advantage arising from factor conditions, demand conditions, related industries, and firm strategy. The Gravity Model of Trade posits that trade volumes are influenced by the economic sizes (GDP) of trading partners and their geographic proximity. Together, these theories provide a comprehensive understanding of international trade, guiding policymakers and economists in navigating the complexities of global markets.

2.2.1 Meaning

International theory is the intellectual framework employed to comprehend and elucidate the intricate patterns of interaction among states and other global actors. It serves as a lens through which to examine a myriad of global phenomena, including war, diplomacy, cooperation, and globalization. By delving into the underlying causes and consequences of these interactions, international theory endeavors to construct generalizable knowledge about world politics. The discipline encompasses a diverse array of theoretical perspectives, such as realism, liberalism, construc-

◆ Framework for trade

tivism, and critical theories, each offering distinct explanations for international behavior and outcomes. These theories vary in their assumptions about the nature of the international system, the primary actors, and the driving forces of international relations. While realism emphasizes the pursuit of power and national interest, liberalism highlights the potential for cooperation and the role of institutions. Constructivism focuses on the social construction of reality and the importance of ideas and norms. Critical theories, on the other hand, challenge the dominant paradigms and seek to expose underlying power structures and inequalities. Ultimately, international theory aims to deepen our understanding of the complex and dynamic global landscape, providing essential tools for analysis, policymaking, and scholarly inquiry.

2.2.2 Types Of International Theories

International theory encompasses a diverse array of perspectives that offer different explanations for global phenomena. While there are numerous theories, some of the most prominent include:

◆ States are primary actions

◆ Role of institutions, interdependence, and democracy

◆ Social constructions

◆ class struggle and economic exploitation

- ◆ **Realism:** This theory posits that states are the primary actors in international relations, driven by the pursuit of power and national interest. Realists argue that cooperation is difficult due to the anarchic nature of the international system, where there is no overarching authority to enforce rules.
- ◆ **Liberalism:** Contending that cooperation is possible and desirable, liberalism emphasizes the role of institutions, interdependence, and democracy in promoting peace and stability. It highlights the importance of economic integration, international law, and human rights.
- ◆ **Constructivism:** This theory focuses on the social construction of meaning and identity, arguing that states' behavior is shaped by shared ideas, norms, and values. Constructivists emphasize the role of discourse, identity, and culture in world politics.
- ◆ **Marxism:** Rooted in the works of Karl Marx, this theory analyzes international relations through the lens of class struggle and economic exploitation. Marxists argue that the global system is inherently unequal, with developed countries benefiting from the exploitation of developing countries.
- ◆ **Critical Theory:** This broad category encompasses various approaches that critique the existing international



- ◆ Challenge dominant narratives

order, including post-colonialism, post-structuralism, and postmodernism. These theories challenge dominant narratives and explore marginalized voices and perspectives.

2.2.3 Mercantilism

- ◆ Emergence of Mercantilism

It was only after the publication of *The Wealth of Nations* by Adam Smith in 1776, the subject of economics emerged in an organized scientific form. Before that during the 17th & 18th centuries in Europe a group of men – like merchants, bankers, traders, government officials, and philosophers, wrote essays and pamphlets on international trade that advocated an economic philosophy known as mercantilism. The term mercantilism first acquired significance at the hands of Adam Smith. Mercantilism, as the term implies is closely associated with trade and commercial activities of an economy. The mercantilist theory was highly nationalistic in its outlook and favored state regulation and centralization of economic activities including foreign trade. The mercantilists believed that a nation's wealth and prosperity were reflected in its stock of precious metals (also known as specie), namely, gold and silver. At that time, as gold and silver were the currency of trade between nations, a country could accumulate gold and silver by exporting more and importing less. The more gold and silver a nation had, the richer and more powerful it was. They argued that the government should do everything possible to maximize exports and minimize imports. However, since all nations could not simultaneously have an export surplus and the amount of gold and silver was limited at any particular point of time, one nation could gain only at the expense of other nations. In other words, mercantilists believed that trade was a zero-sum game (i.e. one's gain is the loss of another). For mercantilists, the objective of foreign trade was considered to be achievement of surplus in the balance of payments. Hence, they advocated achieving as high trade surplus as possible. In this context, Blaug (1978) points out that – “The core of mercantilism, of course, is the doctrine that a favourable balance of trade is desirable because it is somehow productive of national prosperity. When mercantilist authors speak of the surplus in the balance of trade, they mean an excess of exports, both visible and invisible, over imports, calling either for an inflow of gold or for granting of credit to foreign countries, that is capital exports. In other words, they were roughly thinking of what we would now call ‘the current account’ as distinct from ‘the capital account’ in the balance of payments.”

The mercantilist ideas were strongly criticized in the 18th century by economists like David Hume, Adam Smith and David Ricardo. For instance, Adam Smith criticized mercantilists on the ground that the mercantilists falsely equated money with capital,

◆ Mercantilism Flawed

◆ Trade Benefits All

and the favourable balance of trade with the annual balance of income over consumption. Thus, Blaug (1978) critically points out that - “The idea that an export surplus is the index of economic welfare may be described as the basic fallacy that runs through the whole of the mercantilist literature.”

Another flaw of mercantilism is that it viewed trade as a zero-sum game. This view was challenged by Adam Smith and David Ricardo who demonstrated that trade was a positive sum game in which all trading nations can gain even if some benefit more than others. From the above analysis it is seen that the concept of balance of payments or balance of trade was evolved for the first time in the writings of mercantilists. As pointed out earlier, at that time economics was not yet developed in an organized form, so the concept of balance of payments / balance of trade was evolved in a vague form. Despite various flaws in the ideology, due credit may be given to the mercantilist writers in the development of the concept of balance of payments / balance of trade.

2.2.3.1. Three Basic Issues of mercantilism

Mercantilists failed to address three relevant issues of international trade viz

- ◆ Gains from trade – The first important issue is about the gains from trade. Do countries gain from international trade? Where do the gains come from? and how are they divided among the trading countries?
- ◆ Structure of trade – The second relevant issue is the structure or direction or pattern of international trade. In other words, which goods are exported and which are imported by each trading country? What are the fundamental laws that govern the international allocation of resources and the flow of trade?
- ◆ Terms of trade – The third relevant issue is the terms of trade. In other words, at what prices are the exported and imported goods exchanged?

2.2.4 Classical theories of International Trade

It was the classical economists like Adam Smith, David Ricardo, Robert Torrens and John Stuart Mill, who explained these three issues through their theories which can be grouped under classical theories of international trade.

2.2.4.1 Theory of Absolute Cost Advantage

It was Adam Smith who emphasized the importance of free trade in increasing wealth of all trading nations. According to

- ◆ Principle of Absolute advantage

Adam Smith, mutually beneficial trade is based on the principle of absolute advantage. His theory is based on the assumptions that there are two countries, two commodities and one factor (labour) of production. Adam Smith's theory is based on labour theory of value, which asserts that labour is the only factor of production and that in a closed economy goods exchange for one another according to the relative amounts of labour they embody. The principle of absolute cost advantage points that a country will specialize in exporting a commodity in which it has an absolute cost advantage.

2.2.4.2 Comparative Cost Advantage Theory

- ◆ Specialization in Production

According to Ricardo, it is not the absolute but the comparative differences in costs that determine trade relations between two countries. The comparative cost theory was first systematically formulated by the English economist David Ricardo in his Principles of Political Economy and Taxation published in 1817. It was later refined by J. S. Mill, Marshall, Taussig and others. According to Ricardo, differences in comparative costs form the basis of international trade. The law of comparative advantage indicates that each country will specialize in the production of those commodities in which it has the greatest comparative advantage or the least comparative disadvantage. Thus, a country will export those commodities in which its comparative advantage is the greatest and import those commodities in which its comparative disadvantage is the least.

2.2.4.3 Evaluation of the Comparative Cost Theory

- ◆ Limitations of Comparative Cost

The comparative cost doctrine is not complete in itself. It has been severely criticized by economists due to its unrealistic assumptions. Prof. Bertil Ohlin critically pointed out that the principle of comparative advantage does not apply to international trade alone; rather it applies to all trade. Furthermore, the theory does not explain why there are differences in costs. Ricardo's theory of comparative advantage did not explain the ratios at which the two commodities would be exchanged for one another. In other words, it does not indicate what the terms of trade are.

- ◆ Barter system

It was J. S. Mill who discussed this issue in detail in his theory of reciprocal demand. The term 'reciprocal demand' indicates a country's demand for one commodity in terms of the quantities of the other commodity which it is prepared to give up in exchange. Thus, it is the reciprocal demand that determines the terms of trade which, in turn, determines the relative share of each country. Equilibrium would be established at that ratio of exchange between the two commodities at which quantities demanded by each country of the commodity which it imports from the other, should be exactly sufficient to pay for one another.

er. Mill's theory of reciprocal demand relates to the possible terms of trade at which the two commodities will exchange for each other between the two countries. The terms of trade here refer to 'the barter terms of trade' between the two countries i.e. the ratio of the quantity of imports for a given quantity of exports of a country. The Ricardian theory, though based on several wrong assumptions, is regarded as an important landmark in the development of the theory of international trade.

2.2.5 Modern theory of International Trade

One of the main drawbacks of Ricardian theory of comparative cost was that it did not explain why differences in comparative costs existed. In 1919, Eli Heckscher propounded the idea that trade results from differences in factor endowments in different countries. The idea was further carried forward and developed by Bertil Ohlin in 1933 in his famous book *Inter-regional and International Trade*. This book forms the basis for what is known as Heckscher–Ohlin's theory or modern theory of international trade.

◆ Explains the importance of cost

2.2.5.1 Heckscher- Ohlin Theory

The Heckscher – Ohlin theory is based on most of the assumptions of the classical theories of international trade and leads to the development of two important theorems – (a) Heckscher – Ohlin theorem and (b) Factor price equalization theorem. Heckscher & Ohlin have explained the basis of international trade in terms of factor endowments. According to Heckscher & Ohlin, regions or countries have different factor endowments. It means that some countries are rich in capital while some are rich in labour. In their theory, the concept of factor endowments or factor abundance is used in relative terms and not in absolute terms. They have defined the concept of factor endowment or factor abundance in terms of two criteria.

◆ Factor Endowments

- (a) Price criterion and
- (b) Physical criterion.

(a) Price criterion - As per price criterion, a country is said to be capital abundant if the ratio of price of capital to the price of labour (PK / PL) is lower as compared to the other country. This criterion considers both demand for and supply of factors.

◆ Factor Intensity Exports

(b) Physical criterion – As per physical criterion, a country is said to be capital abundant if the ratio of the total amount of capital to the total amount of labour (K/L) is greater as compared to other country. This criterion considers only supply of factors.



Based on the above criterion, the Heckscher – Ohlin theorem states that – “A nation will export the commodity whose production requires the intensive use of the nation’s relatively abundant and cheap factor and import the commodity whose production requires the intensive use of the nation’s relatively scarce and expensive factor.” In other words, the countries in which capital is cheap & abundant will export capital - intensive goods and import labour – intensive goods. On the contrary, the countries in which labour is cheap & abundant will export labour – intensive goods and import capital-intensive goods. Thus, for them it is the differences in factor intensities in the production of goods along with actual differences in factor endowments of the countries which explain international differences in comparative costs of production.

◆ Factor Price Equalization

The Heckscher –Ohlin theory further leads to the development of the factor price equalization theorem. The factor price equalization theorem indicates that free international trade will ultimately lead to equalization of commodity prices and factor prices.

◆ Emphasis on Factor of Production

Economists Paul Samuelson & Wolfgang Stolper have further contributed to this theory and have formed Stolper – Samuelson theorem. Stolper –Samuelson theorem explains the effect of change in relative product prices on factor allocation and income distribution. It postulates that an increase in the relative price of a commodity raises the return or earnings of the factor used intensively in the production of that commodity. In other words, an increase in the relative price of labour-intensive commodity will increase wages. Similarly, an increase in the relative price of capital-intensive commodity will increase the price of capital. This implies that free trade would raise the returns to the abundant factor and reduce the returns to the scarce factor.

◆ Comparative Cost Advantages

2.2.5.2 Evaluation of Heckscher – Ohlin Theory

It is clear from the above that the Heckscher – Ohlin (hence forth, H-O) theory is superior to Ricardian theory. It accepts comparative advantage as the cause of international trade and explains the reasons behind the differences in comparative cost. Thus, it supplements the Ricardian theory of comparative cost. However, one of the limitations of H-O theory is that it is based on static model of given factor endowments and given technology.

2.2.5.3. Product Life Cycle Theory

Vernon (1966) has put forth the product cycle hypothesis. Vernon’s model is a generalization and extension of the technological gap model. It states that the development of a new product moves through a cycle or a series of stages in the course of

- ◆ Emphasis on the different stages of Production

its development, and its comparative advantage changes as it moves through the cycle. As a new product passes through different stages in a domestic market, in a similar way it passes through different stages in the international market. Generally, a product passes through three stages during its lifetime. These stages are - (a) the new product stage, (b) the Maturing product stage, and (c) the Standardized product stage. To conclude, we can say that Posner's technological model stresses the time lag in the imitation process, while Vernon's product cycle model stresses the standardization process. Both the models, try to explain dynamic comparative advantage for new products and new production processes, as opposed to the basic H-O model which explains static comparative advantage.

2.2.5.4 National Competitive Advantage Theory (Porter's National Competitive Advantage Theory)

- ◆ Theory of Innovation

In the continuing evolution of international trade theories, Michael Porter of Harvard Business School developed a new model to explain national competitive advantage in 1990. Porter's theory states that a nation's competitiveness in an industry depends on the capacity of the industry to innovate and upgrade. His theory focused on explaining why some nations are more competitive in certain industries. To explain his theory, Porter identified four determinants that he linked together. The four determinants are (1) local market resources and capabilities, (2) local market demand conditions, (3) local suppliers and complementary industries, and (4) local firm characteristics.

Summarised Overview

International Trade Theories provide frameworks to understand how and why countries engage in trade and the benefits they derive from it. Mercantilism posits that national wealth is maximized through a positive balance of trade, advocating for export promotion and import restriction. The Theory of Absolute Cost Advantage, proposed by Adam Smith, suggests that countries should specialize in producing goods for which they have an absolute efficiency advantage. The Comparative Cost Advantage Theory, developed by David Ricardo, argues that even if a country has no absolute advantage, it can still benefit from trade by specializing in goods it can produce relatively more efficiently. The Heckscher-Ohlin Theory emphasizes that a country will export goods that utilize its abundant and cheap factors of production and import goods that require factors in which it is deficient. The Product Life Cycle Theory explains that a product's location of production and export changes over its life cycle, from innovation to maturity to standardization.



The National Competitive Advantage Theory, also known as Porter's Diamond, identifies four broad attributes that shape the environment in which local firms compete, including factor conditions, demand conditions, related and supporting industries, and firm strategy, structure, and rivalry. These theories collectively provide insights into the dynamics of international trade, guiding countries and businesses in formulating effective trade policies and strategies to enhance economic growth and competitive advantage.

Self-Assessment Question

1. What is global competitiveness?
2. What is the source of competitive advantage?
3. Explain the theory of Mercantilism
4. Write a short note about factor endowment theory.
5. List out the investment theories.
6. What are trade barriers?
7. What are the main differences between the theory of absolute cost advantage and the theory of comparative cost advantage?
8. How does the Heckscher-Ohlin theory explain international trade patterns, and what are its limitations?

Assignments

1. Compare the advantages and disadvantages of various modes of entering foreign markets.
2. Why do we have international strategic alliances? What are the forms and their respective advantages and disadvantages?
3. Analyze the product life cycle theory and its impact on international trade strategies, using case studies from different industries
4. Differentiate the international trade theories.

Suggested Reading

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SGOU

03 BLOCK

Multinational Corporations and Foreign Direct Investment

Block Content

Unit - 1 Multinational Corporations

Unit - 2 Foreign Direct Investment

Unit - 3 Foreign Investment Implementation Authority

Unit 1

Multinational Corporations

Learning Outcomes

After completion of this unit, the learner will be able:

- ◆ to get an awareness on the process of overseas expansion by international companies.
- ◆ to gain knowledge on various arguments in favour of and against the multinational corporations.
- ◆ to learn the impact of foreign direct investment on host countries' domestic economy.
- ◆ to identify measures to attract foreign direct investment.

Background

Multinational corporations (MNCs) are pivotal players in the global economy, characterized by their expansive operations across multiple countries and diverse markets. These entities wield substantial economic influence, leveraging their size and resources to engage in cross-border trade, investment, and production. Originating from developed economies, MNCs establish subsidiaries or affiliates in various nations, often driven by strategic goals such as market expansion, cost efficiencies through labour arbitrage, or access to raw materials. The structure of MNCs typically entails a headquarters in their home country, managing and coordinating operations dispersed across different regions. Their activities span a spectrum of industries, including technology, manufacturing, finance, and services, contributing significantly to employment, technology transfer, and economic growth globally. Critically, MNCs navigate complex regulatory landscapes and cultural diversities, adapting their strategies to local conditions while influencing global economic policies and standards. However, their operations can provoke debates over issues such as labour rights, environmental sustainability, and economic inequality, reflecting the dual role of MNCs as drivers of both prosperity and controversy in the contemporary globalized economy. As key agents of globalization, MNCs foster interconnectedness among economies, shaping consumer behaviour, industrial trends, and geopolitical dynamics. The ongoing evolution of MNCs underscores their adaptive resilience in an increasingly interconnected world, where their strategic decisions

resonate far beyond national borders, shaping the economic landscapes of nations and regions alike.

Keywords

Foreign Direct Investment, Multinational Corporation, Globalisation, FIIA.

Discussions

3.1.1. Multinational Corporation

In this twenty-second century, MNC have become the central institution of developing nations. A significant number of MNCs started their operations in developing countries by the 1990s. The effects of their operations in developing countries are now assessed quite differently from that done in the past. MNCs benefit from the lower labour costs and grants given by the governments of developing countries in order to attract these MNCs. Moreover, lower tax rates or tax exemptions are also given to MNCs for a period in developing countries. On the other hand, these developing countries can also gain from the investment made by these MNCs. MNCs can help reduce poverty, drive economic growth, create jobs that utilize local people, raise employment standards by paying better wages than local firms pay. In addition, they can boost economic development by transferring technology and knowledge, improve or build up infrastructure, raise people's standards of living. Multinational corporations help emerging economies in their modernisation by transferring technology, know-how and skills, providing access to export markets by intensifying competition, by making quality goods available to the consumers vis-a-vis domestic counterparts. Overall, it might seem that the developing countries gain from investments of MNCs.

◆ MNCs: Developing Nations' Boon

◆ MNCs: Double-Edged Sword

Although MNCs have become omnipresent in the developing world, there has always been uncertainty about them, in both positive and negative ways. Most MNCs take advantage of developing countries. They can be guilty of making pollution or doing human rights abuse. Moreover, labourers are paid low wages, as there are few or no trade unions to protect their rights or negotiate with the MNCs. Thus, the theoretical dispute over the effects of MNCs in developing countries is mir-

◆ MNCs: Positive Impact

rored in the conflict. Apparently, two broad positions can be derived from these differences of opinion- the positive and negative. Some proponents have developed arguments that emphasize the positive results of foreign direct investment (FDI) by MNCs. They are willing to admit some gains from FDI. On the contrary, others are unwilling to accept a positive role for multinational capital under any circumstances.

MNCs help a developing host country by increasing investment, income and employment in its economy. They contribute to the rapid process of development of the country through the transfer of technology, finance and modern management. MNCs promote exports of the host country. Multinational companies have played a vital role in the economy of a country in the modern world for many years. These companies promote the growth of trade due to the bulk investment of foreign capital in a country. Foreign direct investment in the industrial sector reduces the amount of commercial debt of a country. Multinational corporations can also be described as firms that produce, distribute, and market in more than one country. Some MNCs are known to wield assets and profits far larger than gross domestic products (GDPs) of most countries in the world and are hence able to influence economic developments, and social relations through the goods and services that they produce and the wealth at their disposal.

3.1.1.1. Multinational Corporation – Meaning

A multinational corporation (MNC) or transnational corporation (TNC), also called multinational enterprise (MNE), is a corporation or an enterprise that manages production or delivers services in more than one country. It can also be referred to as an international corporation. The International Labour Organization (ILO) has defined an MNC as a corporation which has its management headquarters in one country known as the home country and operates in several other countries known as host countries. According to the ILO Report. “The essential nature of the multinational enterprise lies in the fact that managerial headquarter is located in one country (referred to for convenience as the home country) while the enterprise carries out operations in a number of other countries as well”

Stages in the Development of a Multinational Corporation

Typical stages in the growth of a multinational corporation are as follows;

- ◆ The domestic firm begins to export its products abroad through middlemen in the home country.

- ◆ As sales of products increase abroad, the firm begins to sell directly to an importer located abroad. The firm establishes an export department or division in the home country.
- ◆ The firm establishes a sales branch abroad to handle sale and promotional work in a given foreign market. The manager of the sales branch is directly responsible to the home office.
- ◆ An overseas sales subsidiary is established. It is incorporated in a foreign country and hence enjoys, greater autonomy than a sales branch.
- ◆ The firm starts production in the foreign country through contract, manufacturing or assembling operations.
- ◆ A manufacturing facility is established abroad. Now the firm has a subsidiary abroad that, manufactures and sells the product in the foreign -market.
- ◆ The subsidiaries or operating units abroad are integrated and the parent company takes strategic, or, policy decisions, for all subsidiaries. The subsidiaries operate under capitalized planning and control.

3.1.2 Features of A Multinational Company – Mnc

- ◆ **World Wide Operation:** Multinational companies extend their operation to two or more countries. They establish parent office in one country and extend branches, subsidiaries, and affiliation to other countries.
- ◆ **Origin:** The development of MNCs dates back to several centuries, but their real growth started after the Second World War . Majority of the MNCs are from developed countries like the U.S.A, Japan, the UK, Germany and European countries. In recent years MNCs from countries like Korea, Taiwan, India, China, etc. are operating in the world markets.
- ◆ **Unity of Control:** MNCs are characterised by a unity of control. MNCs control business activities of their branches in foreign countries through a head office located in the home country. Managements of branches operate within the policy framework of the parent corporation. The business operations in the host country have their own management and offices, but the ultimate control will still remain at the head office.

- ◆ **MNCs operate on a global scale:** Which means they have huge assets in almost all countries in which they operate. Their turnovers can also be incomprehensibly large. For example, Apple has a market capitalization of 1 trillion dollars.
- ◆ **Profit Motive:** MNCs are profit oriented rather than social oriented. Such corporations do not take much interest in the social welfare activities of the host country.
- ◆ **Advanced Technology:** Multinational companies invest a huge amount of money on research and development of the latest technology. Therefore they transfer advanced technology to developing countries through subsidiaries and branches.
- ◆ **High Efficiency:** Advanced techniques are used by multinational companies. So, manpower can give effective training which increases the efficiency of manpower. Due to this factor, multinational companies can provide a large volume of quality products at a cheaper price.
- ◆ **Ownership and control:** The ownership of such a company is shared by both the parent company and the branch companies as per their capital investment. However, the parent company manages and controls the operation of its branches and subsidiary through trademark, technology, and patent right.
- ◆ **Professional Management:** It is a large organization which has an international name and fame. It has a good network worldwide for the distribution of goods. An MNC employs professionally trained managers to handle huge funds, advanced technology, and international business operations. An MNC is run by very competent and capable individuals. They have suitable managers to take care of their business operations, technology, finances, expansion etc. And they are also able to attract the top talent to their corporations due to their resources and their reputation.
- ◆ **Aggressive Marketing:** MNCs can spend a lot of money on marketing, advertising, and promotional activities. They target an international audience, so effective marketing becomes necessary. Aggressive marketing allows them to capture the market and sell their products globally.
- ◆ **Better Quality of Products:** An MNC has to compete on the global level. It, therefore, has to pay special attention to the quality of its products.

3.1.3 Importance of Multinational Corporations

◆ Global Players

MNCs are characterised by their large size, worldwide operations, international management, mobility of resources and having more than one branch in addition to those in the home country. For many years, they have been playing an important role in the world economy as it is the main actor in the development of the global economy. MNCs try to go into other countries with several aims: exploit the natural resources of the host country, gain tax benefits, mitigate the impact of regulations in the home country, reduce the cost of production by making use of cheap labour and low transportation expenses in the host country, and gain dominance in foreign markets. MNCs bring about interdependence among states. Through the engagement from one to different countries, it tends to influence the states' relation. States try to attract foreign investment to their respective country. As a result, it creates an environment where not only the states' own products, but also products from other countries compete with one another. The presence of MNCs also gradually increases the states' reputation. The number of these private firms in one country can build the trust of other states in that particular state. It assures the stability of those country, and therefore create relationship among states.

The possible benefits of a multinational investing in a country may include:

- ◆ **Development of the Country** - Multinational companies help developing countries to increase efficiency and productivity in production, sales, finance, etc. through the transfer of technology and foreign investment to the host country.
- ◆ **Improving the Balance of Payments** - Inward investment will usually help a country's balance of payments situation. The investment itself will be a direct flow of capital into the country and the investment is also likely to result in import substitution and export promotion. Export promotion comes due to the multinational using their production facility as a basis for exporting, while import substitution means that products previously imported may now be bought domestically.
- ◆ **Providing Employment** – In terms of employment, Multinational corporations hire workers to produce goods on a large scale. More workers are needed when a company needs to increase production. This result can lead to increase in employment.

- ◆ **Source of Tax Revenue** - Profits of multinationals will be subject to local taxes in most cases, which will provide a valuable source of revenue for the domestic government.
- ◆ **Technology Transfer** - Multinationals will bring with them technology and production methods that are probably new to the host country and a lot can therefore be learnt from these techniques. Workers will be trained to use the new technology and production techniques and domestic firms will enjoy the benefits of the new technology. This process is known as technology transfer.
- ◆ **Increasing Choice** - If the multinational manufactures for domestic markets as well as for export, then the local population will gain from a wider choice of goods and services and at a price possibly lower than imported substitutes.
- ◆ **National Reputation** - The presence of one multinational company may improve the reputation of the host country and other large corporations may follow suit and consider the country as a potential business partner.
- ◆ **Improvement in Standard of Living** -By providing the best quality products and services at a better price, MNCs help to improve the standard of living of people of host countries.

3.1.4 Forms of Multinational Corporation

Multinational corporations (MNCs) are companies that operate in multiple countries beyond their home base. They come in various forms, each with distinct characteristics and strategies for managing their international operations. Here are the main types:

1. **Decentralized Corporation** Decentralized MNCs give a lot of independence to their local branches. Each branch makes decisions suited to its own market. This allows the company to be flexible and quickly respond to local needs, preferences, and regulations. However, it can also lead to inefficiencies and a lack of unity in the company's overall strategy.
2. **Centralized Corporation** Centralized MNCs, on the other hand, keep tight control at the headquarters. Local branches have limited decision-making power, with most strategic decisions made centrally. This ensures consistency in brand, policies, and practices across all locations, enhancing efficiency and streamlining operations. However, it can reduce

the ability to quickly adapt to local markets.

3. **Global Corporation** Global corporations operate with a global strategy and see the world as one big market. They emphasize standardization and economies of scale, producing and marketing their products in a similar way everywhere. This approach can significantly reduce costs and create a unified brand image, but it may overlook local preferences and market differences.
4. **Transnational Corporation** Transnational corporations blend global and local strategies. They have a network structure where each branch can adapt to local conditions while also using the corporation's global strengths. This hybrid approach balances global efficiency with local responsiveness. It encourages innovation and knowledge sharing across borders, making it a highly dynamic form of MNC.
5. **International Corporation** International corporations expand abroad to use the strengths they developed at home. They transfer these strengths to foreign markets while keeping significant control over operations. This form focuses on exploiting the company's strengths internationally but may struggle with adapting to diverse market conditions

3.1.5 Multinational Corporations vs. Domestic Corporations

While an MNC has a physical presence in two or more countries, domestic corporations have operations in only one country. They may still import supplies or sell their products around the world, but they don't have corporate offices or management located in countries other than their home base.

Table 1: Comparison of Multinational and Domestic firms

Multinational Corporations	Domestic Corporations
Physical presence in many countries.	Physical presence in one country.
More complex business model	Simpler business model

Subject to International Financial Reporting Standards (IFRS).	Subject to Generally Accepted Accounting Principles (GAAP).
Can outsource to foreign markets for cheaper labour costs and taxes	Subject to the labour costs and tax rules of their home country.
Often criticized for outsourcing jobs abroad and for negative impacts on the countries in which they do business	May be praised for keeping jobs in their home country.

3.1.6 Role of MNCs in Developing Countries

MNCs have contributed significantly to the development of world economy at large. They have also served as an engine of growth in many host countries. Multinational corporations (MNCs) play a pivotal role in the economic development of developing host countries by injecting significant investment, generating income, and creating employment opportunities. Their presence fosters rapid development through the transfer of crucial technology, financial resources, and modern management practices. Moreover, MNCs contribute to the professionalization of management within local companies, promoting efficiency and competitiveness in the business landscape. By facilitating exports and producing essential goods domestically, MNCs reduce the host country's dependence on imports, thereby bolstering economic self-sufficiency and resilience.

◆ Development Engine

The entry of MNCs stimulates market competition, breaking domestic monopolies and fostering a more dynamic business environment. Their involvement accelerates the growth process by catalysing industrialization and allied activities, driving overall progress and prosperity. Beyond economic benefits, MNCs also contribute positively to the social fabric of host countries by championing modernization, fostering cultural exchange, and actively participating in social welfare initiatives. Their expansion improves the host country's balance of payments status and integrates national and international markets, reshaping economic, industrial, and social dynamics on both local and global scales. Overall, MNCs serve as agents of modernization, peace, and prosperity, leaving a lasting impact on the development trajectory of host countries. By basically seeking maximisation of profits by using all types of resources and strategies of the global economy, eventually globalisation has become the main focus of their business. In this way, it has become a main propelling force behind the expansion of world economy at large.

◆ Positive Globalization Force

3.1.6.1 Impact of multinational companies on host countries

Job creation:

Multinational companies create employment opportunities. They also tend to pay more than local firms do in host countries. Training programmes will also improve the quality and efficiency of local workforce. Therefore, more of the local workforce will be employed to work in the multinational companies. MNCs directly employ a number of host country citizens. It is also observed that MNCs pay better wages to their employees so this enhances the standard of living of their employees thereby leading to indirect employment for other citizens of the host country

Boost to the Local Economy:

Multinational companies help to increase the value of a country's annual output by producing and selling high volume of products. They will also boost export earnings for the host country by selling products abroad. This will create consumption expenditure since more people are in paid employment, and boost the host country's Gross Domestic Product (GDP). Therefore, the overall standard of living will be improved.

More Tax Revenue for Local Governments:

The income generated by the multinational companies will be taxable in the host country. The government in a host country will receive more corporate tax revenues from Profits made by multinational companies. Most of the multinational companies tend to be highly profitable year after year. This will lead to more income for the government to spend on important public services such as health care and education.

Bringing new Managerial Skills and Technology

Multinational companies introduce new skills and technology in production processes to host countries. With new ideas in management and technology transfers, the efficiency of production in the host country will be raised. Management expertise in the community will slowly improve. The foreign managers might be replaced by local staff once they are suitably qualified. For example Japanese multinational firms have introduced quality management tools to the rest of the world. These techniques of quality improvement such as Kaizen, Kanban, Andon, Quality Circles or Total Quality Management (TQM) have been widely adopted by many companies around the world.

Intensify Competition – Improved Quality

With multinational companies on the market, local businesses will be forced to improve their quality and productivity



up to international standards to compete with the multinationals. It is because without the threat from multinational companies, domestic firms do not necessarily have the incentive to be innovative or to respond market forces. Higher competition will lead to greater efficiency to the benefit of domestic customers.

Increase in Choices of Products

Domestic customers will have access to a greater variety of goods and services as there is more competition. Therefore, customers will be able to benefit from more choices. Also, due to competition and better production methods, the quality of goods may be higher too.

Improvement of the Country's Reputation

Multinational companies will invest in a foreign country that has a positive regulatory and economic environment. Usually, Governments of host countries provide incentives to multinational companies to set up in areas with high unemployment and a plentiful supply of labour. This may encourage other multinational companies to set up there as well.

Improvements in Infrastructure

Very often, multinational companies have to invest in transportation and communication networks as they produce and sell large volumes of products. This may benefit everyone in the host country. New technology and techniques that are being used by the multinational companies, as well as advanced knowledge, will be shared with local employees. In that way, local companies that will hire those workers in the future could learn from them and improve.

Improvement of the Balance of Payments

Multinational companies with global presence will export their goods to other countries. Hence, exports of the host country will increase. At the same time, imports may reduce as the multinational companies may be able to provide the products previously imported to the domestic customers. Above all, the balance of payment of the host country will be improved.

Local Suppliers Can Gain New Customers

Local producers and suppliers are likely to benefit from the increased presence of multinational companies in the country. They will be supplying raw materials, components and finished goods, as well as services, and this will generate additional jobs and higher sales revenues for those suppliers.

Exploitation of the Local Workforce

Some multinational companies have been criticized for paying low wages to workers in poor countries. Especially, when the

host country faces high unemployment and workers are low skilled. Also, due to the absence of strict labour, health and safety rules in some underdeveloped and developing countries, multinationals can employ cheap labour for long hours with fewer of the benefits that the staff in their home country would demand.

Higher Pollution and Environmental Damage

Pollution levels from manufacturing plants in underdeveloped and developing countries might be at higher levels than allowed in other developed countries. It might be because of many reasons. Multinational companies aim to produce goods as quickly and as cheaply as possible, and in doing so may ignore their impact on the environment. Also, it might be because of slack rules of the host country's government that do not insist on environmentally acceptable practices. Otherwise, it may drive multinational companies away.

Repatriation of Profits to Home Countries

Many multinational companies send back the profits that they earn in host countries to their home country. Profits may be sent back to the country where the head office of the company is based, rather than being kept for reinvestment in the host nation. Multinational companies can create wealth in the host country, and the profits are repatriated to the home country in the end. This will leave the host country with very little financial benefit.

Exploitation of Natural Resources

Sometimes multinational companies set up their operations in host countries, so that they can have easier and cheaper access to natural resources. Extensive depletion of the limited natural resources of some countries has been blamed on some large multinational corporations. The argument is that they have little incentive to conserve these resources, as they are able to relocate quickly to other countries once resources have run out. In the long-term this may lead to scarcity of that natural resource in the host country. Anti-globalization groups are concerned about the social responsibility of multinational companies in their attempt to grow and exploit the planet's scarce resources.

Less Sense of Corporate Social Responsibility (CSR) and Negative Social Impact

Most of the multinational companies are Public Limited Companies. They are mainly driven by profit as investors demand dividends and capital gains. Hence, they may not pay much attention to health and safety of workers and customers,



if the laws of the host country are not very strict. Host nations are often unable to control the actions of large multinational companies, due to their sheer market power. The marketing done by multinational companies can greatly affect the lifestyle, food habits and culture of the host communities. This may mean that traditional products and practices disappear leading to a reduction in cultural identity.

Small Local Companies May Go out of Business

Since multinational companies are large and are experts in their area of operation, they are also cost-efficient. Usually, they can provide better quality goods at lower prices. Local companies that provide the same goods may suffer in such a case, therefore be squeezed out of business due to inferior equipment and much smaller resources. Due to fierce competitive pressures, domestic firms might be forced into reducing prices to remain competitive.

Contributing to Severe Unemployment

Multinational companies are capable of causing severe unemployment in the host country. It is because they are so good at what they do that they can pose a threat to domestic businesses. Competition can be good when it causes local firms to improve their performance. But, competition can also be bad when domestic firms are unable to compete on equal terms ending up with laying off redundant workers, or even having to shut down the business in the worst-case scenario.

Intensified Pressure on Local Governments:

Many of the Foreign Direct Investments (FDIs) made by multinational companies are huge amounting to hundreds of millions of USD\$. This will greatly affect the economic conditions of the host country by positively contributing to the economic growth. However, there is no free lunch. In exchange for this investment, multinational companies may try to lobby and influence government policies so that they affect them in a favourable way. Hence, there might be undue influence on local governments. This will not be good for the host country in the long-term as the government may feel like its being held hostage by a single company.

Transfer Pricing

Multinationals will always aim to reduce their tax liability to a minimum. One way of doing this is through transfer pricing. The aim of this is to reduce their tax liability in countries with high tax rates and increase them in the countries with low tax rates. They can do this by transferring components and part-finished goods between their operations in different countries at differing prices. Where the tax liability is high, they transfer the goods at a relatively high price to make the costs appear higher. This is then

recouped in the lower tax country by transferring the goods at a relatively lower price. This will reduce their overall tax bill.

Creation of Monopoly Power

Mega mergers and acquisitions in host countries by MNCs result in the creation of monopoly power. Creation of monopoly power in economy distorts efficient allocation of resources and causes a substantial loss of consumer surplus. This can undermine national goals and welfare.

Increase in Income Inequality

MNCs pay wages and salaries to their employees at a higher rate than domestic firms. As a result there is increase in income inequalities. Increasing inequalities give rise to social unrest and many social evils. If there is gross inequality in any country then people in the lower income group are highly affected during the time of inflation.

3.1.7. Issues Faced By Multinational Corporations (Mncs)

Multinational corporations (MNCs) play a significant role in the global economy, driving innovation, creating jobs, and fostering international trade. However, operating across multiple countries presents a complex array of challenges that can impact their success and sustainability. This essay will explore the primary issues faced by MNCs, including cultural differences, regulatory and legal compliance, economic risks, ethical and social responsibility, supply chain management, reputation management, political risks, competition, technology transfer, and human resources.

Cultural Differences

One of the most significant challenges for MNCs is navigating cultural differences. These differences can manifest in communication styles, management practices, and business etiquette. For instance, hierarchical structures in some cultures might clash with more egalitarian approaches in others. Misunderstandings can arise from language barriers, non-verbal cues, and differing business customs. Effective cross-cultural communication and management training are crucial for MNCs to bridge these gaps and foster a cohesive corporate culture.

Regulatory and Legal Compliance

MNCs must comply with the legal and regulatory frameworks of each country in which they operate. This includes adhering to varying laws related to labour, environment, taxation, and corporate governance. Navigating these complexities

requires a deep understanding of local regulations and a robust compliance strategy. Failure to comply can result in hefty fines, legal battles, and damage to the corporation's reputation. Differing tax regimes can lead to challenges in managing tax liabilities and avoiding double taxation.

Economic Risks

Operating in multiple countries exposes MNCs to various economic risks, including currency fluctuations, inflation, and economic instability. Exchange rate volatility can significantly impact the profitability of international operations, as revenues and costs are often denominated in different currencies. Economic instability in host countries, such as recession or hyperinflation, can disrupt business operations and supply chains. MNCs must employ sophisticated financial strategies, such as hedging, to mitigate these risks.

Ethical and Social Responsibility

MNCs are increasingly held accountable for their ethical and social responsibilities. Issues such as labour practices, environmental impact, and human rights are scrutinized by consumers, governments, and NGOs. MNCs must ensure fair labor practices, provide safe working conditions, and avoid exploitative practices, especially in countries with weaker labour laws. They must manage their environmental footprint by adhering to local and international environmental regulations. Corporate Social Responsibility (CSR) initiatives are essential for maintaining a positive reputation and meeting stakeholder expectations.

Supply Chain Management

Managing a global supply chain is a complex and challenging task for MNCs. They must coordinate production, transportation, and distribution across various countries while maintaining quality and efficiency. Logistics challenges, such as shipping delays, customs regulations, and transportation costs, can disrupt the supply chain. Additionally, ensuring consistent product quality and adhering to different standards and regulations in each market are significant hurdles. Advanced supply chain management systems and technologies are vital for optimizing operations and mitigating risks.

Reputation Management

Maintaining a consistent brand image and reputation across different markets is crucial for MNCs. Brand consistency can be challenging due to varying cultural perceptions and consumer preferences. Negative incidents in one country, such as labour rights violations or environmental disasters, can tarnish the global reputation of an MNC. Effective communication strategies,

crisis management plans, and robust CSR initiatives are essential for protecting and enhancing the corporate brand.

Political Risks

MNCs must navigate a complex landscape of political risks, including changes in government, regulatory shifts, and geopolitical tensions. Political instability, such as coups, revolutions, or civil unrest, can disrupt business operations and threaten the safety of employees. Nationalization of assets, expropriation, and changes in trade policies can also pose significant risks. MNCs must engage in thorough political risk assessments and develop strategies to manage and mitigate these risks, such as diversifying investments and building strong relationships with local stakeholders.

Competition

MNCs face intense competition from both local and global companies. Local competitors often have a better understanding of the market, consumer behaviour, and regulatory environment, giving them an edge. MNCs must compete with other multinationals that may have superior resources and capabilities. To stay competitive, MNCs must continuously innovate, adapt to local market conditions, and leverage their global presence to achieve economies of scale and scope.

Technology Transfer

Transferring technology and knowledge across borders presents unique challenges for MNCs. Protecting intellectual property (IP) is a significant concern, especially in countries with weaker IP enforcement. MNCs must ensure that their technology and innovations are not copied or misused by local competitors. Adapting technology to suit local market conditions and regulatory requirements can be complex and costly. Strategic partnerships, joint ventures, and robust IP protection mechanisms are essential for successful technology transfer.

Human Resources

Managing human resources in a multinational context involves recruiting, training, and retaining talent across different countries. MNCs must navigate diverse labour markets, varying employment laws, and cultural differences in workplace practices. Attracting and retaining skilled employees can be challenging, especially in regions with talent shortages or high competition for top talent. Providing consistent training and development opportunities, creating inclusive and diverse workplaces, and offering competitive compensation and benefits are crucial for building a strong global workforce.

Multinational corporations face a myriad of challenges that require sophisticated strategies and continuous adaptation.



◆ Global Challenges

Cultural differences, regulatory and legal compliance, economic risks, ethical and social responsibility, supply chain management, reputation management, political risks, competition, technology transfer, and human resources are critical areas that MNCs must navigate to achieve success in the global market. By addressing these issues proactively and strategically, MNCs can leverage their global presence to drive innovation, growth, and positive impact worldwide.

◆ Criticism of MNC operations in India: Prioritization

3.1.8 Criticisms Against Mncs In India

The operations of multinational corporations (MNCs) in India have faced opposition on various fronts. Critics argue that MNCs prioritize mergers and acquisitions over initiating fresh projects, relying heavily on financial resources sourced from within the country while supplying outdated machinery and focusing solely on short-term profits, often at the expense of national interests and disregarding local issues. They tend to employ expatriate management rather than promoting competitive Indian talent, repatriating substantial profits to their home countries despite collecting capital locally. Critics also highlight their reluctance to adopt suitable technology and their tendency to increase their stake in ventures once established, often favouring the production of non-essential goods over addressing essential needs, exacerbating concerns about their impact on the local economy and development.

◆ MNC impact

MNCs play an important role in developing countries. They can create more employment opportunities for the huge labour force, train them and promote the development of high-level skills. Moreover, MNCs have been declared as the engines of global economic development, prosperity, technological transfer, economic integration, and deepening globalization. Although it has been argued that globalization has played a vital role in improving the standards of living throughout the world, many critics have asserted that MNCs have assumed the role of exploitative tools and are no more than predators in developing countries.

Summarised Overview

Multinational Corporations (MNCs) are expansive entities operating in numerous countries, exhibiting distinct characteristics that distinguish them from domestic enterprises. These characteristics include having a headquarters in one nation while maintaining subsidiaries or branches in multiple countries, enabling them to navigate diverse regulatory environments and exploit global markets. MNCs assume various forms, including horizontal integration, where they acquire or merge with competitors in the

same industry; vertical integration, allowing them to control various stages of the production process; and conglomerates, diversifying across unrelated industries to spread risk and maximize profit potential. In the global economy, MNCs play pivotal roles as engines of innovation, economic growth, and job creation, fostering technology transfer and knowledge dissemination across borders. They facilitate international trade, investment flows, and the development of supply chains, contributing significantly to both national and global prosperity. However, MNCs also face scrutiny and criticism for various issues. Concerns revolve around labour rights abuses, such as poor working conditions and low wages in developing countries where MNCs often outsource production. Environmental degradation is another issue, as MNCs may engage in unsustainable practices that harm ecosystems and communities. Moreover, their pursuit of profit maximization sometimes leads to tax avoidance strategies, depriving governments of the revenue needed for public services and infrastructure. Additionally, MNCs' sheer size and influence can pose challenges to national sovereignty and economic inequality, as they wield significant power over governments and markets. Despite these criticisms, MNCs remain indispensable actors in the global economy, necessitating ongoing efforts to address their shortcomings while harnessing their potential for sustainable and inclusive development.

Self-Assessment Question

1. What are the objectives of multinational corporations?
2. What are the objectives scope and importance of Multinational Corporation?
3. What is the role and importance of multinational corporations in international business?
4. What are the characteristics of a multinational corporation?
5. What are the types of MNC?
6. Do the positive effects of multinational corporations outweigh the negative effects?
7. What are some risks that MNCs face?
8. Name a multinational company example.
9. What are the top 10 multinational companies?
10. Is Coca-Cola multinational?
11. Why are MNCs important for a country?
12. What are the advantages of a Multinational Corporation?

Assignments

1. Write a comprehensive essay analysing the characteristics of multinational corporations. Include examples of MNCs from different industries and regions to illustrate these characteristics.
2. Conduct a case study on a specific multinational corporation and evaluate its organizational form. Compare and contrast the different forms of MNCs, such as horizontal integration, vertical integration, and conglomerates, and assess the advantages and disadvantages of each.
3. Prepare a presentation exploring the role of multinational corporations in the global economy. Discuss their impact on international trade, investment, technology transfer, and economic development, drawing on relevant theories and empirical evidence.
4. Write a research paper examining the ethical and social responsibility issues associated with multinational corporations. Investigate cases of labor rights abuses, environmental degradation, and other ethical dilemmas faced by MNCs, and propose strategies for addressing these challenges.
5. Analyse the regulatory framework governing multinational corporations in a specific country or region. Evaluate the effectiveness of existing regulations in promoting accountability, transparency, and responsible business conduct, and recommend policy reforms or improvements.
6. Conduct a comparative study of multinational corporations operating in different industries or sectors. Examine how industry-specific factors influence the behaviour and strategies of MNCs, and assess their implications for economic performance and social welfare.

Suggested Reading

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2. Anant R. Negandhi (1987). *International Management*, Prentice-Hall of India, New Delhi.
3. Cherunilam Francis (2010). *International Business- Text and Cases* (Fifth Edition). PHI Learning Private Limited, New Delhi.
4. C. Fernando (2011). *Business Environment*, Pearson India, India
5. K Chidambaram, V Alagappan (1999). *Business Environment*, Vikas Publishing House, India
6. Pailwar V K (2014). *Business Environment*, PHI Learning Pvt. Ltd, New Delhi, India
7. PrabhakaranPaleri (2014). *Business Environment*, Cengage Learning, New Delhi, India

Space for Learner Engagement for Objective Questions

Learners are encouraged to develop objective questions based on the content in the paragraph as a sign of their comprehension of the content. The Learners may reflect on the recap bullets and relate their understanding with the narrative in order to frame objective questions from the given text. The University expects that 1 - 2 questions are developed for each paragraph. The space given below can be used for listing the questions.

SGOU



Unit 2

Foreign Direct Investment

Learning Outcomes

After completion of this unit, the learner will be able to:

- ◆ define Foreign Direct Investment and Foreign Portfolio Investment
- ◆ learn about the difference between FDI and FPI
- ◆ get an awareness of the various types of Foreign Direct Investment
- ◆ know the composition of Foreign Direct Investment in India

Background

The investment made by a company or individual from one nation into commercial interests situated in another is known as foreign direct investment (FDI), and it is a crucial part of global economic activity. Due to factors including globalisation, trade and investment policy liberalisation, and improvements in communication and technology, foreign direct investment (FDI) has gained prominence over time. Foreign direct investment (FDI) enables investors to take control of or significantly influence the management and operations of the foreign firm through the construction of new facilities, the purchase of existing assets, or involvement in joint ventures. Market-seeking incentives to reach new markets and customers, efficiency-seeking incentives to take advantage of cost advantages like lower labour or resource costs, and strategic incentives to broaden their global reach, diversify their business, or acquire cutting-edge technologies and know-how are some of the factors that propel foreign direct investment (FDI) flows. By generating employment, boosting economic expansion, transferring managerial and technological know-how, encouraging competition and innovation, and improving trade and productivity, foreign direct investment (FDI) supports economic development. Concerns about corporate governance, social and environmental effects, national sovereignty, and economic stability are only a few of the risks and issues associated with FDI. Thus, in order to attract and regulate foreign investment in a way that maximises benefits for host countries while minimising potential negatives, governments must carefully weigh the risks and benefits of FDI.

Keywords

Foreign Direct Investment, Foreign Portfolio Investment, Brownfield FDI, Green field FDI

Discussion

3.2.1 Foreign Direct Investment

In the era of globalization, Foreign Direct Investment takes an important part in the development of both developed and developing countries. It provides a number of benefits like innovative products, the overture of new technology, opportunities for employment, an extension of new markets, and the introduction of new skills etc., which reflect in the growth of income of any country. FDI is one of the measures of growing economic globalization. Investment has always been a matter for developing nations such as India. The world has been globalizing and all the countries are liberalizing their policies for welcoming investment from nations which have ample capital resources. The nations which are already developed are concentrating on new markets where there is the availability of a huge amount of labour, the scope for products, and high profits are attained. In emerging markets, FDI has become a battleground.

◆ FDI benefits

An important feature of globalization since the 1990s has been the inflow of foreign direct investment in developing countries including India. India has been one of the most attractive destinations for FDI in recent years. As the government is taking its steps back from economic activities, a big space is created for the private sector, both domestic and foreign. The Government also finds FDI to be an important source of development financing. It may not only fill the space vacated by public sector, but also accelerate the rate of economic growth by increasing the volume of capital and increases the efficiency of the productive factors by increasing competition, introducing better technology and management expertise. In developing countries, FDI is now viewed as an attractive alternative source of development financing as the government finds it difficult to finance the increasing demand of socio-economic needs of the country. Besides, FDI also brings foreign exchange and eases balance of payment difficulties. Taking all these factors into account, the developing countries are making far reaching changes in their economic policies to attract FDI into the country.

◆ FDI significance

Foreign direct investment plays a pivotal role in the process of economic development particularly in the capital scarce coun-

◆ FDI: Role in Economic Development

try, where the domestic base of created assets like technology, skills and entrepreneurship is quite limited. It provides financial resources for investment in a host country and thereby augments domestic saving efforts. It also plays an important role in accelerating the pace of economic growth. FDI provides the much needed foreign exchange to help bridge the balance of payments or trade deficit. FDI brings complementary assets such as technology, management and organizational competencies and there are spill over effects of these assets on the rest of the economy. FDI is treated as a main engine of economic growth and technological development which provides ample opportunities in accelerating economic development. FDI contributes to exports directly and an enhanced export possibility contributes to the growth of the host economies by relaxing demand side constraints on growth. World investment report 2002 defines FDI as an investment involving a long term relationship and reflecting a lasting interest and control by a resident entity in one economy in an enterprise resident in an economy other than that of the FDI enterprise. FDI according to UNCTAD implies that the investor exerts a significant degree of influence on the management of the enterprise resident in the other economy. Encouragement of FDI is an integral part of the economic reforms process of developing nations because it is seen as an instrument of technology transfer, managerial skill, and augmentation of foreign exchange reserves and globalization of the economy. Economic growth, continuing liberalization of investment policies and trade regimes, and increased competition among firms are likely to drive the global expansion of MNC activity.

3.2.2 Foreign Direct Investment Meaning

Foreign direct investment refers to a category of cross-border investment associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy (IMF, 2009). Foreign Direct Investment implies an investment made with an intent of obtaining an ownership stake in an enterprise domiciled in a country by an enterprise situated in some other country. The investment may result in the transfers of funds, resources, technical know-how, strategies, etc. There are several ways, of making FDI viz, creating a joint venture or through merger and acquisition or by establishing a subsidiary company. The investor company has a substantial amount of influence and control over the investee company. Moreover, if the investor company obtains 10% or more ownership of equity shares, then voting rights are granted along with the participation in the management.

3.2.3 Difference Between Fdi And Fpi

Every country requires capital for its economic growth and the funds cannot be raised alone from its internal sources alone. Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI) are the two ways through which foreign investors can invest in an economy. FDI connotes a cross-border investment, by a resident or a company domiciled in a country, to a company based in another country, with an objective of establishing a lasting interest in the economy. FPI connotes a route to funds into a nation, where foreign residents can buy securities from the country's stock or bond market. Both FDI and FPI involve the acquisition of a stake in an enterprise which is domiciled in another country. But, these two differ in the nature of holdings, terms, degrees of control, etc. Come, let's understand the difference between FDI and FPI, in detail.

Table 1: Difference between FDI and FPI

Basis of Difference	FDI	FPI
Meaning	FDI refers to the investment made by the foreign investors to obtain a substantial interest in the enterprise located in a different country.	When an international investor, invests in the passive holdings of an enterprise of another country, i.e. investment in the financial asset, it is known as FPI.
Role of investors	Active	Passive
Degree of control	High	Very less
Type of Investment	Direct Investment	Indirect Investment
Involvement	Long term interest in the company, therefore, involved in management and ownership control.	Looking for short term gains, therefore no active involvement in the managerial activities.

Term	Long term	Short term
Type of Assets	Physical assets and stakes in the foreign companies. (Financial and also Non-Financial Assets).	Financial assets of the foreign country like stocks, bonds and also ETFs.
Entry and Exit	Difficult	Relatively easy
Motive	Business expansion.	Generating returns to the investor.
Volatility	Stable	Volatile

3.2.4 Types of Foreign Direct Investment

When a company invests in another company in a foreign land, the investment is said to be a foreign direct investment. The FDIs are further categorised into four types.

3.2.4.1 Horizontal FDI

Horizontal Foreign Direct Investment (FDI) involves a company investing in foreign markets to engage in the same type of business activities it conducts in its home country. Unlike vertical FDI, where a company invests in different stages of production or distribution, horizontal FDI aims to replicate the company's existing business model in a foreign market. This type of investment is driven by various factors, including expanding market reach, accessing new customer segments, diversifying risks, or capitalizing on cost advantages. One of the primary motivations for horizontal FDI is to tap into new markets and leverage existing competencies to gain a competitive edge. By establishing operations in foreign countries that share similar characteristics to their domestic market, companies can benefit from economies of scale, brand recognition, and established distribution channels. This approach allows firms to extend their product or service offerings to a broader customer base without significant modifications to their business model. Horizontal FDI also facilitates knowledge transfer and technology diffusion across borders. When companies expand internationally, they bring with them managerial expertise, operational practices, and innovative technologies. This transfer of knowledge not only benefits the investing company but also contributes to the development of the host country's human capital and industry capabilities.

◆ Horizontal FDI:
Replication Abroad

3.2.4.2 Vertical FDI

Vertical FDI is where an investment is made within the supply chain, but not directly in the same industry. In other words, a business invests in a foreign firm that it may supply or sell too. Vertical FDIs are further categorised as backward vertical integrations and forward vertical integrations. For instance, Hersheys, a US chocolate manufacturer, may look to invest in Cocoa producers in Brazil. This is known as backwards vertical integration because the firm is purchasing a supplier, or potential supplier, in the supply chain. The Swiss Coffee producer Nescafe may invest in coffee plantations in countries such as Brazil, Columbia, Vietnam, etc. Since the investing firm purchases, a supplier in the supply chain, this type of FDI is known as backward vertical integration. We then have forward vertical integration. So this is where a firm invests in a foreign company that is further along in the supply chain. For instance, Hersheys may look to purchase a share in Alibaba; where it sells its products. When a firm sells the goods into the local or regional market (i.e., acting as a distributor), this is termed forward vertical FDI.

◆ Vertical FDI: Supply Chain Control

3.2.4.3 Conglomerate FDI

Conglomerate FDI is where an investment is made in a completely different industry. In other words, it is not linked in any direct way to the investor's business. For instance, Walmart, a US retailer, may invest in Tata motors, an Indian automobile manufacturer. This may seem strange to some but offers big businesses an opportunity to expand and diversify into new areas. To explain, some big businesses come to a point where the demand for its fundamental business starts to decline. In order to survive, it must invest in new ventures. Even big businesses with strong demand may look to new industries where growth and returns on investment are significantly larger.

◆ Diversification

3.2.3.4 Platform FDI

Platform FDI (Foreign Direct Investment) refers to investment by a foreign entity into a specific platform or infrastructure that serves as a facilitator or intermediary for other businesses to operate within a particular market or ecosystem. This type of investment typically involves creating or supporting a platform that enables various businesses, entrepreneurs, or individuals to engage in economic activities more efficiently. In the case of platform FDI, a business expands into a foreign country, but the products manufactured are exported to another, third country.

◆ Facilitation

3.2.5 Methods of Foreign Direct Investment

There are many ways through which FDI is done. Here we will talk about the most prominent methods of foreign direct in-

◆ FDI Methods

◆ Greenfield Investment

vestment. Methods of FDI can be divided into two broad categories – Greenfield investments and brownfield investments. When a company of a different country invests in the business of another country or wants to expand their horizon in another country, two things become important. One is how they should build up their business or influence to generate enough revenue in a foreign country. And another is what would be the most profitable methods of FDI. To understand this, let's look at two methods of FDI.

3.2.5.1 Greenfield Fdi

A green field investment is a form of foreign direct investment where a company establishes operations in a different country. The company makes provisions for the independence of the subsidiary company by constructing new facilities (manufacturing and distribution hubs, administrative offices). All costs and activities pertaining to the creation of a new subsidiary in a foreign country are sponsored by the parent company.

Features of Greenfield FDI

- ◆ The Investor has complete control over the operations of the subsidiary entity / new unit.
- ◆ The subsidiary unit /new unit gets extensive help from the parent company.
- ◆ The brand image of the parent company expands in international markets.
- ◆ This setup creates domestic employment opportunities.
- ◆ It follows the 'High-Risk High Return' principle. Greenfield investors earn more than Brownfield investors.
- ◆ Developing countries encourage this type of FDI by giving subsidies and tax benefits.
- ◆ It allows the investing company to be flexible according to its requirements. Existing acquisition forces the acquiring company to adjust according to the current setup. Greenfields allows being super flexible.
- ◆ The maintenance cost of the new plant is comparatively lower than the maintenance cost of the existing plant.

3.2.5.2 Brownfield FDI

Brownfield FDI is an investment made by a foreign company in existing production arrangements. An important form of Brownfield investment is merger and acquisition by foreign MNCs in India. Here, a domestic company is taken over by

◆ Existing Capacity Purchase

the MNC. Brownfield FDI is different from Greenfield FDI. Greenfield FDI makes additional production capacity, whereas Brownfield FDI is the purchase of existing production capacities. The latter is just a transfer of ownership of an existing firm from a domestic entrepreneur to a foreign one. Disadvantage of Brownfield FDI as a source of investment is that it doesn't create expansion of production capacities or employment generation. In the case of foreign direct investment, companies usually prefer to go for brownfield investment. It means the purchase or lease of pre-existing facilities in a foreign country. In some cases, the investing companies are required to purchase additional equipment, while in other cases they need to upgrade the existing equipment. Nevertheless, in both cases, it is often more cost effective than setting up a new facility from scratch, which is the case with Greenfield investment.

Features of Brownfield FDI

- ◆ **Time-saving:** As the investor doesn't need to build the infrastructure, the time taken to initiate production is reduced.
- ◆ **Local Intelligence:** In the case of a merger with a local company, the benefits of local knowledge add to the advantage of the investor as they don't need to do the ground-level research in understanding local needs and requirements.
- ◆ **Boost to the Local Economy:** Due to the quicker initiation of production, the local economy is boosted quickly by increased jobs and increased GDP.
- ◆ **Environmental Benefits:** The local environment betters as the investor helps in cleaning up the hazardous waste of past industrial activities, which would end up getting deteriorated if left neglected. This is done in the case of the Brownfield redevelopment process, where the land previously used for some other purpose is redeveloped for a new use and therefore helps in better aesthetics and community environment to live in.
- ◆ **Renovation:** Old, dilapidated buildings get renovated, and therefore it leads to a reduction in the risk of their falling apart and causing loss of life and property.
- ◆ **Local Regulations:** At times, when the investment takes place in emerging economies, the local regulations are less liberal as compared to that of the developed economies leading to a lack of ease in doing business.

3.2.6 Features of Foreign Direct Investment

◆ Economic growth

The creation of jobs is the most obvious advantage of FDI, one of the most important reasons why a nation (especially a

developing one) will look to attract foreign direct investment. FDI boosts the manufacturing and services sector which results in the creation of jobs and helps to reduce unemployment rates in the country. Increased employment translates to higher incomes and equips the population with more buying power, boosting the overall economy of a country. FDI can stimulate a target country's economic development and create a more conducive environment for companies, and investor, and stimulate the local community and economy.

- ◆ **Human Capital Development**

Human capital involves the knowledge and competence of a workforce. Skills that employees gain through training and experience can boost the education and human capital of a specific country. Through a ripple effect, it can train human resources in other sectors and companies.

- ◆ **Technology**

Targeted countries and businesses receive access to the latest financing tools, technologies, and operational practices from all across the world. The introduction of newer and enhanced technologies results in the company's distribution into the local economy, resulting in enhanced efficiency and effectiveness of the industry.

- ◆ **Increase in Exports**

Many goods produced by FDI have global markets, not solely domestic consumption. The creation of 100% export oriented units helps to assist FDI investors in boosting exports to other countries.

- ◆ **Exchange Rate Stability**

The flow of FDI into a country translates into a continuous flow of foreign exchange, helping a country's Central Bank maintain a prosperous reserve of foreign exchange which results in stable exchange rates.

- ◆ **Improved Capital Flow**

Inflow of capital is particularly beneficial for countries with limited domestic resources, as well as for nations with restricted opportunities to raise funds in global capital markets.

- ◆ **Creation of a Competitive Market**

By facilitating the entry of foreign organizations into the domestic marketplace, FDI helps create a competitive environment, as well as break domestic monopolies. A healthy competitive environment pushes firms to continuously enhance their processes and product offerings, thereby fostering innovation. Consumers also gain access to a wider range of competitively priced products.



◆ Hindrance of domestic investment

Sometimes FDI can hinder domestic investment. Because of FDI, countries' local companies start losing interest to invest in their domestic products.

3.2.7 Advantages of Foreign Direct Investments

Foreign Direct Investment (FDI) offers several advantages to both the host country and the investing country. Here are some key benefits:

For the Host Country:

Economic Growth and Development:

FDI brings capital into the host country, which can be used for infrastructure development and other capital-intensive projects. This inflow of capital supports the establishment of new businesses and the expansion of existing ones, creating employment opportunities. Additionally, the introduction of new technologies and practices through FDI can enhance productivity.

Technological Advancement:

FDI often brings advanced technology and know-how that may not be available domestically, facilitating technology transfer. It also promotes the training and development of the local workforce, improving skill levels.

Access to International Markets:

Multinational companies can provide access to new markets for the host country's products, boosting export growth. Integration into global supply chains through FDI can increase the efficiency and competitiveness of local industries.

Enhanced Competition and Innovation:

Increased competition from foreign companies can lead to more efficient market conditions, promoting market efficiency. Exposure to new ideas and practices through FDI can also stimulate innovation within the host country.

Improvement in Balance of Payments:

FDI can improve the capital account balance by providing a stable source of capital. Additionally, increased production for export can help improve the current account balance.

For the Investing Country:

Access to New Markets:

Firms can expand their market reach, increasing their sales and revenue by entering new markets. Investing in foreign markets also helps diversify business operations and reduce dependence on domestic markets.

Resource Acquisition:

FDI provides access to raw materials and natural resources that may not be available domestically. It also allows firms to tap into skilled labour and talent in the host country.

Cost Efficiency:

Reduced labour and production costs in the host country can lead to higher profit margins for investing firms. Additionally, some countries offer tax incentives and benefits to attract FDI, further improving cost efficiency.

Strategic Assets:

Acquiring companies with advanced technology or expertise through FDI can provide a competitive edge. Furthermore, gaining established brands and market positions in the host country can strengthen the investing firm's market presence.

Enhanced Corporate Image:

Investing in developing countries can enhance the corporate image and reputation of the investing firm by contributing to the host country's development, demonstrating corporate social responsibility (CSR).

3.2.8 Disadvantages of Fdi

Foreign Direct Investment (FDI) can have several disadvantages for both the host country and the investing country, despite its many benefits. Here are some key drawbacks:

For the Host Country:**Economic Dependence:**

Heavy reliance on FDI can make the host country vulnerable to economic instability if foreign investors decide to withdraw their investments. This dependency can lead to economic shocks and uncertainty.

Loss of Control:

When foreign companies acquire significant stakes in local businesses, the host country may lose control over key industries. This can result in foreign interests prioritizing their own goals over national priorities, potentially undermining local economic policies and strategies.

Profit Repatriation:

Foreign investors often repatriate profits back to their home countries, which can lead to a net outflow of capital from the host country. This reduces the amount of reinvested profits that could have otherwise supported local economic development.

Adverse Effects on Local Businesses:

Increased competition from well-established foreign firms can negatively impact local businesses, especially small and

medium-sized enterprises (SMEs). These local businesses may struggle to compete with the superior technology, expertise, and financial resources of foreign companies.

Cultural and Social Impacts:

The influence of foreign companies can lead to cultural homogenization, where local traditions and practices are overshadowed by foreign ways of doing business. This can result in the erosion of local cultures and values.

For the Investing Country:

Political and Economic Risks:

Investing in foreign countries exposes firms to political and economic risks, such as changes in government policies, expropriation, and political instability. These risks can lead to significant financial losses.

Resource Allocation:

FDI may divert resources and capital away from domestic investment opportunities, potentially leading to underinvestment in the home country. This can impact the domestic economy and slow down national growth.

Management Challenges:

Operating in foreign markets involves navigating different regulatory environments, cultural differences, and business practices. These complexities can create management challenges and increase operational costs for the investing firm.

3.2.9 Composition of the Foreign Direct Investment in India

Foreign direct investment (FDI) plays a crucial role in India's economic growth. Here's a breakdown of its composition based on two key aspects:

1. Source Countries:

FDI inflows into India come from various countries around the world. Following are the top sources (as of FY 2023-24):

- ◆ **Mauritius (25%):** This high percentage is partly due to the routing of investments through Singapore and other financial centers.
- ◆ **Singapore (23%):** Singapore is a major financial hub and a key source of direct foreign investment for India.
- ◆ **USA (9%):** The United States remains a significant source of FDI, particularly in technology and services sectors.
- ◆ **Netherlands (7%):** Dutch companies are involved in various sectors in India, including manufacturing and infra-

structure.

- ◆ **Japan (6%):** Japanese investment is prominent in the automobile and manufacturing sectors.

2. Sectors Attracting FDI:

The Indian government allows FDI in various sectors, and the composition of inflows varies depending on the investment climate and government policies. Here's a look at the top sectors attracting FDI (as of FY 2023-24):

- ◆ **Services Sector (Finance, Banking, Insurance, Non Fin/ Business, Outsourcing, R&D, Courier, Tech. Testing and Analysis, Other) (16%):** India's growing services sector is a major draw for foreign investors.
- ◆ **Computer Software & Hardware (15%):** India's IT industry is a global leader, attracting significant FDI in software development and hardware manufacturing.
- ◆ **Trading (6%):** Trading activities, including imports and exports, also attract foreign investment.
- ◆ **Telecommunications (6%):** The telecommunications sector in India is undergoing rapid growth, attracting FDI in mobile networks and broadband infrastructure.
- ◆ **Automobile Industry (5%):** The Indian automobile industry is a major recipient of FDI, with foreign carmakers setting up manufacturing plants in the country.

FDI Favoured Sectors of the Indian Economy

The Indian economy welcomes FDI (Foreign Direct Investment) in a variety of sectors, but some consistently attract a larger share of the inflows.:

Top Favoured Sectors:

- ◆ **Services Sector (16%):** This broad category encompasses various sub-sectors like finance, banking, insurance, business services, outsourcing, R&D, and tech-related services like testing and analysis. India's growing services sector, with its skilled workforce and competitive costs, makes it a magnet for foreign investors.
- ◆ **Computer Software & Hardware (15%):** India's IT industry is a global leader, attracting significant FDI in software development and hardware manufacturing. Government's initiatives like Digital India further bolster this sector's attractiveness.
- ◆ **Telecommunications (6%):** India's rapid telecommunications growth, with expanding mobile networks and



broadband infrastructure, presents a lucrative opportunity for foreign investors.

Other Prominent Sectors:

- ◆ **Automobile Industry (5%):** The Indian automobile industry is witnessing significant FDI, with established foreign carmakers setting up manufacturing plants in the country. The growing middle class and increasing demand for vehicles drive investment in this sector.
- ◆ **Trading (6%):** This includes import and export activities, which are crucial for India's economic growth. Foreign investment facilitates smoother trade flows and access to international markets.

3.2.10 FDI Policy Framework

Foreign Direct Investment (FDI) plays a critical role in propelling India's economic growth. It injects capital, fosters innovation, and creates employment opportunities. Recognizing this importance, India has established a dynamic FDI policy framework that continuously evolves to attract investment in strategic sectors. Here's a deep dive into this framework, exploring its key elements and recent advancements:

1. Regulatory Framework:

India's FDI policy is governed by a multi-layered framework encompassing various entities:

- ◆ **The Department for Promotion of Industry and Internal Trade (DPIIT):** This department under the Ministry of Commerce and Industry is the nodal agency for FDI policy formulation and implementation. It issues press notes clarifying and updating FDI regulations across various sectors.
- ◆ **The Foreign Exchange Management Act (FEMA), 1999:** This act regulates foreign exchange inflows and outflows, including FDI. It empowers the Reserve Bank of India (RBI) to issue detailed guidelines for FDI transactions.
- ◆ **Sector-Specific Regulations:** Different ministries may have additional regulations specific to their sectors. For instance, the Department of Telecommunications (DoT) governs FDI in telecom, while the Ministry of Health and Family Welfare regulates FDI in healthcare.

2. Routes for FDI Entry:

There are three primary routes for FDI entry into India:

- ◆ **Automatic Route:** This route allows approval-free FDI up to a certain percentage in specific sectors. The percentage

limit varies depending on the sector and the type of investment (equity, technology transfer, etc.). The DPIIT maintains a consolidated FDI policy document specifying automatic route approvals for various sectors.

- ◆ **Government Approval Route:** Certain sectors considered sensitive or strategic require prior government approval from relevant ministries or departments before FDI can be received. The approval process may involve scrutiny of the investment proposal, ensuring alignment with national interests.
- ◆ **Sectoral Regulator Route:** Some sectors have their own regulatory bodies responsible for FDI approvals. For example, the Insurance Regulatory and Development Authority of India (IRDAI) governs FDI in the insurance sector.

3. Recent Policy Reforms:

The Indian government has undertaken significant reforms in recent years to liberalize FDI regulations and improve the ease of doing business:

- ◆ **Relaxation of FDI Limits:** Several sectors have witnessed an increase in permissible FDI limits under the automatic route. This simplifies the process for foreign investors and promotes faster inflow of capital.
- ◆ **Focus on Ease of Doing Business:** Initiatives like the Single Window System for clearances and online applications for approvals streamline the FDI process for investors.
- ◆ **Promoting Specific Sectors:** The government actively promotes FDI in priority sectors like infrastructure, manufacturing (through “Make in India”), and renewable energy. This includes offering special incentives and relaxing regulations for these sectors.
- ◆ **Focus on Ease of Exit:** Regulations have been eased for foreign investors seeking to exit their investments in India, making the market more attractive.

4. Key Features of the Framework:

India’s FDI policy framework boasts several key features:

- ◆ **Conditional Liberalization:** While liberalizing FDI in many sectors, the government maintains control in strategic areas like defence and media to protect national security and cultural interests.



- ◆ **Performance-Linked Incentives:** To encourage job creation and technology transfer, the government offers performance-linked incentives to FDI projects meeting specific criteria.
- ◆ **Focus on Regional Development:** Special economic zones (SEZs) and other initiatives aim to attract FDI and promote balanced regional development.

5. Challenges and Opportunities:

India's FDI policy framework faces some challenges:

- ◆ **Complex Regulatory Environment:** The multi-layered regulatory structure can be complex for foreign investors to navigate.
- ◆ **Infrastructure Bottlenecks:** Inadequate infrastructure in certain areas can hinder the smooth operation of FDI-driven projects.
- ◆ **Limited Labor Reforms:** Rigid labour laws might deter some foreign investors seeking greater flexibility.

However, significant opportunities exist:

- ◆ **Growing Domestic Market:** India's burgeoning domestic market presents a vast potential consumer base for foreign companies.
- ◆ **Skilled Workforce:** India boasts a large pool of skilled professionals, making it a lucrative investment destination.
- ◆ **Government Focus on Infrastructure:** The government's focus on improving infrastructure will further improve the attractiveness of the Indian market for FDI.

India's FDI policy framework is a dynamic and evolving system. By continuously adapting to meet the needs of investors and fostering economic growth, India seeks to position itself as a global leader in attracting foreign direct investment. The future success of this framework hinges on addressing existing challenges, such as simplifying regulations and addressing infrastructure issues, while capitalizing on its vast potential. As India's economy continues to grow, its FDI policy framework will play a critical role in shaping its economic landscape and propelling it towards a prosperous future.

In India, there are several laws regulating FDI inflows. They are:

- ◆ Companies Act
- ◆ Securities and Exchange Board of India Act, 1992 and SEBI Regulations

- ◆ Foreign Exchange Management Act (FEMA)
- ◆ Foreign Trade (Development and Regulation) Act, 1992
- ◆ Civil Procedure Code, 1908
- ◆ Indian Contract Act, 1872
- ◆ Arbitration and Conciliation Act, 1996
- ◆ Competition Act, 2002
- ◆ Income Tax Act, 1961
- ◆ Foreign Direct Investment Policy (FDI Policy)

Government Authorities in India concerning FDI

- ◆ Foreign Investment Promotion Board (FIPB)
- ◆ Department for Promotion of Industry and Internal Trade (DPIIT)
- ◆ Reserve Bank of India (RBI)
- ◆ Directorate General of Foreign Trade (DGFT)
- ◆ Ministry of Corporate Affairs, Government of India
- ◆ Securities and Exchange Board of India (SEBI)
- ◆ Income Tax Department
- ◆ Several Ministries of the GOI such as Power, Information & Communication, Energy,

Summarised Overview

Foreign Direct Investment (FDI) plays a crucial role in global economies by facilitating cross-border investments where businesses or individuals from one country invest in enterprises located in another. Its significance lies in fostering economic growth, job creation, and technology transfer in host countries, thereby boosting infrastructure and industrial development. Advantages of FDI include access to new markets, enhanced productivity through technology and management practices, and increased capital inflows. However, disadvantages can arise, such as economic dependence on foreign investors, potential exploitation of resources, and risks of economic instability due to capital flow volatility. Different types of FDI include horizontal, vertical, and conglomerate investments, each impacting industries differently based on the nature of business integration. In India, the FDI policy framework has evolved to attract investments across sectors, with regulatory reforms aimed at easing entry norms, enhancing transparency, and fostering investor confidence. The policy also includes sector-specific regulations to manage ownership limits, prioritize strategic sectors, and ensure national security interests. India's approach reflects a balancing act between economic liberalization and safeguarding domestic interests, aiming to harness FDI for sustainable economic growth while protecting national sovereignty and developmental goals.



Self-Assessment Question

1. What is an FDI?
2. What are three factors that impact a company's decision to invest in a country?
3. What is the difference between vertical and horizontal FDI? Give one example of an industry for each type.
4. What are the different types of FDIs?
5. How can governments encourage or discourage FDI?
6. How many categories of FDI are there in India?
7. What are the different methods of foreign direct investment?
8. What is the significance of FDIs?
9. Which of the following sector is prohibited from FDI in India?
10. FDI in India is regulated under which Act? Explain.
11. How many types of FDIs are there in India?
12. What is meant by Foreign Investment, Foreign Direct Investment and Foreign Portfolio Investment?
13. Do foreign direct investment inflows indirectly affect gross domestic product?
14. Tata opens some new dealerships in the United States (note that Tata doesn't produce any cars in the U.S.). Is this an example of horizontal or vertical foreign direct investment? Explain.
15. Is exporting to a country an example of foreign direct investment? Explain.

Assignments

1. Conduct a comparative analysis of the importance of FDI in different regions or countries. Evaluate the factors that attract FDI and assess the impact of FDI on economic growth, employment, and development outcomes.
2. Prepare a case study on a multinational corporation's FDI project in a specific industry or sector. Analyze the motivations behind the investment, the entry mode chosen, and the outcomes achieved in terms of market expansion, technology transfer, and local economic development.
3. Develop a presentation comparing different types of FDI, including greenfield investments, mergers and acquisitions, and joint ventures. Discuss the characteristics, benefits, and risks associated with each type of FDI, and provide examples to illustrate their application in practice.
4. Analyze the role of FDI in promoting sustainable development goals (SDGs). Identify examples of FDI projects that contribute to poverty reduction, gender equality, environmental sustainability, and inclusive growth, and assess their effectiveness in

achieving these objectives.

5. Evaluate the FDI policy framework in India and its impact on investment inflows and economic development. Assess recent reforms aimed at liberalizing FDI regulations, improving the investment climate, and enhancing India's competitiveness as an investment destination.
6. Conduct a case study on a recent FDI project in India and assess its compliance with the country's FDI policy framework. Analyze the regulatory approval process, investment conditions, and outcomes achieved in terms of job creation, technology transfer, and local value addition.
7. Explore the challenges and opportunities of FDI in emerging markets. Investigate factors such as political risk, regulatory uncertainty, and infrastructure constraints, and propose strategies for attracting and managing FDI in these environments.

Suggested Reading

- John Daniels, Lee Radebaugh, Daniel Sullivan *International Business*, Pearson Education, New York.
- Anant Kumar Sundaram and J, Stewart Black, *The International Business Environment: Text and Cases*, PHI, New Delhi
- Rakesh Mohan Joshi, *International Business*, Oxford University Press, New Delhi.

Reference

1. Cherunilam Francis, *International Business- Text and Cases*, Himalaya Publishing House, Mumbai.
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3. P. Subba Rao, *International Business*, Himalaya Publishing House, Mumbai.
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SGOU

Unit 3

Foreign Investment Implementation Authority

Learning Outcomes

After completing this unit the learner will be able to

- ◆ learn about Foreign Investment Implementation Authority (FIIA)
- ◆ get an awareness on the various objectives of Foreign Investment Implementation Authority (FIIA)
- ◆ explain the international experience on FDI Policies

Background

One important organisation charged with assisting and supervising the execution of foreign investment laws and regulations inside India is the Foreign Investment Implementation Authority (FIIA). FIIA was created to expedite the process of luring and overseeing foreign investment, and it is essential to the advancement of economic growth, innovation, and worldwide competitiveness. Its duties usually consist of giving foreign investors advice and information, processing investment applications, granting licences and permits, keeping an eye on whether investment regulations are being followed, and mediating conflicts between foreign investors and host governments. To overcome investment impediments, foster best practices in investment promotion and protection, and to establish an environment that is favourable to investment, FIIA collaborates closely with pertinent government agencies, industry players, and international organisations. The Foreign Investment Authority (FIIA) facilitates increased investment inflows, fosters accountability, efficiency, and openness in the foreign investment process, and optimises the advantages of foreign investment for the economy of the host nations. Along with these the FIIA must balance the interests of international and domestic investors, maintain regulatory uniformity, and address issues of national security, sovereignty, and social and environmental repercussions. Therefore, in order to achieve sustainable and equitable development results, FIIA must adopt a comprehensive approach to foreign investment management by including economic, social, and environmental factors into its policies and procedures.

Keywords

Foreign Investment Implementation Authority, FDI Policy

Discussion

3.3.1 The Foreign Investment Implementation Authority (Fiia)

The Foreign Investment Implementation Authority (FIIA) was set up in 1999 by the Indian Government. Foreign Investment Implementation Authority (FIIA) was established in the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry to facilitate quick translation of Foreign Direct Investment approvals in implementation, provide a proactive one-stop aftercare service to foreign investors by helping them obtain necessary approvals, sort out operational problems and meet with various government agencies to find the solution to problems of the investors. The FIIA may co-opt other secretaries to the Government of India, Chief Commissioner (NRI), top functionaries of financial institutions and professional experts from industry and commerce, as and when necessary. The Foreign Investment Implementation Authority (FIIA), designed to assist foreign direct investors with respect to post-approval operational problems is also serviced by the Secretariat for Industrial Assistance (SIA) in the DIPP. There is a need to strengthen both the FIPB and the FIIA so as to increase their effectiveness in removing procedural bottlenecks and reducing bureaucratic red tape. The Transaction of Business rules should be modified to empower the Foreign Investment Implementation Authority (FIIA) so as to enable it to fix the time frame for investment related approvals both at the State and Central levels. In regard to Central level approvals, FIIA would be empowered to bring persistent delays to the attention of the Cabinet Committee on Foreign Investment so that it can issue appropriate directions to the administrative ministries if they fail to respond conclusively within the prescribed time limit.

◆ FIIA: Helping Foreign Investors in India

3.3.2 Various Objectives of Foreign Investment Implementation Authority (Fiia) Are -

- ◆ Encourage fast translation of the approval of foreign direct investment and also its implementation.
- ◆ Offer the foreign investors proactive services such as, get-

ting them the approvals that are necessary.

- ◆ Solve their problems by meeting the various agencies of the government, and also to solve the various operational problems.

The Fast Track Committee (FTC) that has been set up in around 30 departments of the Indian Government helps Foreign Investment Implementation Authority (FIIA) in its tasks. The chairman of Foreign Investment Implementation Authority (FIIA) is the Secretariat for Industrial Assistance (SIA) of the Department of Industrial Promotion and Policy.

3.3.3 Role of Foreign Investment Implementation Authority (Fiia)

- ◆ Understand and solve the problems of the investors.
- ◆ Understand and solve the problems of the approving authorities.
- ◆ Refer the cases that have not been resolved at the level of FIA to the agencies at the higher levels.
- ◆ Start consultations with multiple agencies.

The primary function was to act as a bridge between foreign investors and the complex bureaucratic landscape of India. FDI projects, despite government approval, could face hurdles during implementation due to:

- ◆ **Multi-layered Approvals:** Clearances from various government departments and state authorities were often required, leading to delays and frustration for investors.
- ◆ **Lack of Coordination:** Different departments might have conflicting regulations or overlapping jurisdictions, creating confusion and bureaucratic bottlenecks.
- ◆ **Limited Investor Support:** Foreign investors might lack familiarity with local procedures and face difficulties navigating the system.

The FIIA aimed to address these challenges by:

- ◆ **Streamlining Approvals:** Facilitating communication and coordination between different government agencies involved in the project's implementation.
- ◆ **Providing Single Window Clearance:** Acting as a central point of contact for investors, reducing the need to interact with multiple departments.



- ◆ **Resolving Impediments:** Identifying and resolving issues that hindered the smooth execution of FDI projects. This could involve mediating disputes, facilitating approvals, or finding solutions to regulatory hurdles.
- ◆ **Promoting Investor Confidence:** By offering assistance and easing bureaucratic burdens, FIIA aimed to create a more welcoming and transparent environment for foreign investment.

Decline

FIIA's existence during a period of increasing FDI inflows suggests its potential role in facilitating the smooth implementation of foreign investments.

Several factors contributed to the decline of FIIA:

- ◆ **Evolution of FDI Policy:** The Indian government initiated reforms to simplify the FDI approval process and establish dedicated nodal agencies.
- ◆ **Focus on Ease of Doing Business:** Initiatives like the Single Window System for clearances and online applications for approvals aimed to streamline the FDI process for investors.
- ◆ **Strengthening Investment Promotion Agencies:** The establishment of Invest India as a single window facilitator for foreign investors potentially reduced the need for a separate implementation authority.

The FIIA served as a stepping stone in India's FDI journey. Its legacy lies in highlighting the importance of investor support and navigating the complexities of project implementation. While the specific entity may no longer exist, the core function it served – facilitating smooth FDI implementation – remains critical for India's continued growth and success in attracting foreign investment.

3.3.4 Fdi Policy: The International Experience

Foreign direct investment is treated as an important mechanism for channelizing the transfer of capital and technology and is thus perceived to be a potent factor in promoting economic growth in the host countries. Moreover, multinational corporations consider FDI as an important means to reorganize their production activities across borders in accordance with their corporate strategies and the competitive advantage of host countries. These considerations have been the key motivating elements in the evolution and attitude of EMEs towards investment flows from abroad in the past few decades particularly since the eight-

ies. This section reviews the FDI policies of selected countries.

China

Foreign direct investment has long played a crucial role in driving the development of China's economy. China continues to be one of the world's most attractive investment destinations, being the second largest FDI recipient for the past several years. It is estimated that in 2020, even against the backdrop of a challenging global economic environment, China hit a new record of more than \$140 billion in FDI, up more than 6% on the year. The Chinese authorities have recently made a whole series of regulatory changes to support the continuation of this trend.

- ◆ Encouragement to FDI has been an integral part of the China's economic reform process. It has gradually opened up its economy for foreign businesses and has attracted large amount of direct foreign investment.
- ◆ Government policies were characterized by setting new regulations to permit joint ventures using foreign capital and setting up Special Economic Zones (SEZs) and Open Cities. The concept of SEZs was extended to fourteen more coastal cities in 1984. Favourable regulations and provisions were used to encourage FDI inflow, especially export-oriented joint ventures and joint ventures using advanced technologies in 1986.
- ◆ Foreign joint ventures were provided with preferential tax treatment, the freedom to import inputs such as materials and equipment, the right to retain and swap foreign exchange with each other, and simpler licensing procedures in 1986. Additional tax benefits were offered to export-oriented joint ventures and those employing advanced technology.
- ◆ Priority was given to FDI in the agriculture, energy, transportation, telecommunications, basic raw materials, and high-technology industries, and FDI projects which could take advantage of the rich natural resources and relatively low labor costs in the central and northwest regions.
- ◆ China's policies toward FDI have experienced roughly three stages: gradual and limited opening, active promoting through preferential treatment, and promoting FDI in accordance with domestic industrial objectives. These changes in policy priorities inevitably affected the pattern of FDI inflows to China.

- ◆ Encouragement to FDI has been an integral part of China's economic reform process. It has gradually opened up its economy for foreign businesses and has attracted a large amount of direct foreign investment.

Chile

- ◆ In Chile, the policy framework for foreign investment, embodied in the constitution and in the Foreign Investment Statute, is quite stable and transparent and has been the most important factor in facilitating foreign direct investment. Under this framework, an investor signs a legal contract with the state for the implementation of an individual project and in return receives a number of specific guarantees and rights.
- ◆ Foreign investors in Chile can own up to 100 percent of a Chilean based company, and there is no time limit on property rights. They also have access to all productive activities and sectors of the economy, except for a few restrictions in areas that include coastal trade, air transport and the mass media.
- ◆ Chile attracted investment in mining, services, electricity, gas and water industries and manufacturing.
- ◆ Investors are guaranteed the right to repatriate capital one year after its entry and to remit profits any time.
- ◆ Although Chile's constitution is based on the principle of non-discrimination, some tax advantages are extended to foreign investors such as the invariability of income tax regime, invariability of indirect taxes, and special policy regime for large projects.
- ◆ In Chile, the policy framework for foreign investment, embodied in the constitution and in the Foreign Investment Statute, is quite stable and transparent and has been the most important factor in facilitating foreign direct investment.

Malaysia

To become a high income economy Malaysia requires a sufficient level of foreign capital and thus is implementing appropriate investment initiatives to stimulate economic activity. So far, Malaysia has only been able to attract a small number of foreign investors. With a relatively small amount of FDI flowing into the country, the expectations of the Economic Transformation Program (ETP) that heavily rely on FDI may be challenged.

- ◆ The Malaysian FDI regime is tightly regulated in that all foreign manufacturing activity must be licensed regardless of the nature of their business.

- ◆ Until 1998, foreign equity share limits were made conditional on performance and conditions set forth by the industrial policy of the time.
- ◆ In the past, the size of foreign equity share allowed for investment in the manufacturing sector hinged on the share of the products exported in order to support the country's export-oriented industrial policy.
- ◆ FDI projects that export at least 80 percent of production or production involving advanced technology are promoted by the state and no equity conditions are imposed. Following the crisis in 1997-98, the restriction was abolished as the country was in need of FDI.

Korea

- ◆ The Korean Government maintained distinctive foreign investment policies giving preference to loans over direct investment to supplement its low level of domestic savings during the early stage of industrialization. Korea's heavy reliance on foreign borrowing to finance its investment requirements is in sharp contrast to other countries.
- ◆ The Korean Government had emphasized the need to enhance absorptive capacity as well as the indigenization of foreign technology through reverse engineering at the outset of industrialization while restricting both FDI and foreign licensing. This facilitated Korean firms to assimilate imported technology, which eventually led to the emergence of global brands like Samsung, Hyundai, and LG.
- ◆ The Korean Government pursued liberalized FDI policy regime in the aftermath of the Asian financial crisis in 1997-98 to fulfil the conditionality of the International Monetary Fund (IMF) in exchange for standby credit.
- ◆ Several new institutions came into being in Korea immediately after the crisis. Invest Korea is Korea's national investment promotion agency mandated to offer one-stop service as a means of attracting foreign direct investment, while the Office of the Investment Ombudsman was established to provide investment after-care services to foreign-invested companies in Korea. These are affiliated to the Korea Trade Investment Promotion Agency.
- ◆ Korea enacted a new foreign investment promotion act in 1998 to provide foreign investors with incentives which include tax exemptions and reductions, financial support for employment and training, cash grants for R&D proj-

ects, and exemptions or reductions of leasing costs for land for factory and business operations for a specified period.

- ◆ One of the central reasons for the delays in the construction process in Korea is said to be the lengthy environmental and cultural diligence on proposed industrial park sites. (OECD, 2008).
- ◆ The Korean Government maintained distinctive foreign investment policies giving preference to loans over direct investment to supplement its low level of domestic savings during the early stage of industrialization.

Thailand

- ◆ Thailand followed a traditional import-substitution strategy, imposing tariffs on imports, particularly on finished products in the 1960s. The role of state enterprises was greatly reduced in the 1950s and investment in infrastructure was raised. Attention was given to nurturing the institutional system necessary for industrial development. Major policy shift towards export promotion took place by early 1970s due to balance of payments problems since most of the components, raw materials, and machinery to support the production process, had to be imported.
- ◆ On the FDI front, in 1977 a new Investment Promotion Law was passed which provided the Board of Investment (BOI) with more power to provide incentives to priority areas and remove obstacles faced by private investors. After the East Asian financial crisis, the Thai government has taken a very favorable approach towards FDI with a number of initiatives to develop the industrial base and exports and progressive liberalization of laws and regulations constraining foreign ownership in specified economic activities.
- ◆ The Alien Business Law, which was enacted in 1972 and restricted majority foreign ownership in certain activities, was amended in 1999. The new law relaxed limits on foreign participation in several professions such as law, accounting, advertising and most types of construction, which have been moved from a completely prohibited list to a less restrictive list of businesses.
- ◆ The spectacular performance of China in attracting large amounts of FDI could be attributed to its proactive FDI policy comprising setting up of SEZs particularly exports catering to the international market, focus on infrastructure and comparative advantage owing to the low labour costs. A

comparison of the FDI policies pursued by select emerging economies, set out above, suggests that policies although broadly common in terms of objective, regulatory framework and focus on technological upgradation and export promotion, the use of incentive structure and restrictions on certain sectors, have varied across countries. While China and Korea extend explicit tax incentives to foreign investors, other countries focus on stability and transparency of tax laws. Similarly, while all the countries promote investment in manufacturing and services sector, China stands out with its relaxation for agriculture sector as well. It is, however, apparent that though policies across countries vary in specifics, there is a common element of incentivisation to attract foreign investment.

Table 1: FDI Policy and Institutional Framework in Select Countries

	Year of Lib- era- lisa- tion	Objective	Incentives	Priority Sectors	Unique features
China	1979	Transfor- mation of traditional agriculture, promotion of industrializa- tion, infra- structure and export promotion.	Foreign joint ventures were provided with preferential tax treatment. Additional tax ben- efits to export-oriented joint ventures and those employing advanced technology. Privi- leged access was provided to supplies of water, electricity and transportation (paying the same price as state-owned enterprises) and to interest-free RMB loans.	Agriculture, ener- gy, transportation, telecommunica- tions, basic raw materials, and high-technology industries.	Setting up of Special Economic Zones
Chile	1974	Technol- ogy trans- fer, export promotion and greater domestic competition.	Invariability of tax regime intended to provide a stable tax horizon.	All productive ac- tivities and sectors of the economy, except for a few restrictions in areas that include coastal trade, air trans- port and the mass media.	Does not use tax incentives to attract foreign investment.

Korea	1998	Promotion of absorptive capacity and indigenisation of foreign technology through reverse engineering at the outset of industrialisation while restricting both FDI and foreign licensing.	Businesses located in Foreign Investment Zone enjoy full exemption of corporate income tax for five years from the year in which the initial profit is made and 50 percent reduction for the subsequent two years. High-tech foreign investments in the Free Economic Zones are eligible for the full exemption for three years and 50 percent for the following two years. Cash grants to high-tech green field investment and R&D investment subject to the government approval.	Manufacturing and services	Loan-based borrowing to an FDI-based development strategy till late 1990s.
Malaysia	1980s	Export promotion	No specific tax incentives.	Manufacturing and services.	Malaysian Industrial Development Authority was recognised to be one of the effective agencies in the Asian region
Thailand	1977	Technology transfer and export promotion	No specific tax incentives. The Thai Board of Investment has carried out activities under the three broad categories to promote FDI. 1. Image building to demonstrate how the host country is an appropriate location for FDI. 2. Investment generation by targeting investors through various activities. 3. Servicing investors	Manufacturing and services	

Summarised Overview

One important organisation in charge of assisting and supervising the application of foreign investment laws and regulations in India is the Foreign Investment Implementation Authority (FIIA). Leveraging worldwide expertise, FIIA expedites the process of luring and overseeing foreign investment, contributing significantly to economic growth, innovation, and increased global competitiveness. Its duties usually comprise giving advice and information to foreign investors, handling applications for investments, granting licences and permits, keeping an eye on adherence to investment laws, and mediating conflicts between foreign investors and host governments. The goal of FIIA is to establish a favourable investment climate that stimulates increased investment inflows and optimises the advantages of foreign investment for the economy of host nations by utilising best practices and lessons gained from international peers. To guarantee successful implementation and lasting development outcomes, however, localising international expertise to local contexts necessitates giving careful thought to institutional capability, regulatory frameworks, and socioeconomic situations.

Self-Assessment Question

1. What is FIIA?
2. What are the objectives of FIIA?
3. Write a note on FDI Policy framework in India.
4. Write a note on FDI and International Experience?
5. Which international organization provides support and guidance for FIIAs in developing countries?
6. What is the purpose of conducting a comparative analysis of FIIAs in different countries?
7. What are some typical functions performed by a FIIA?
8. What are the common challenges faced by FIIAs?

Assignments

1. Write a paper outlining the role and functions of Foreign Investment Implementation Authorities (FIIAs) in three different countries. Compare and contrast their approaches to facilitating foreign investment, addressing regulatory challenges, and promoting economic development.
2. Select a case study of a country that has successfully attracted foreign investment through effective FIIA management. Analyze the factors contributing to the FIIA's success, such as institutional capacity, regulatory framework, and stakeholder engagement.



3. Prepare a policy brief recommending strategies for strengthening Foreign Investment Implementation Authorities (FIAs) based on international experience
4. Prepare a presentation on a specific aspect of FIIA management, such as investment promotion, regulatory compliance, or dispute resolution
5. Conduct a comparative analysis of the Foreign Investment Implementation Authorities (FIAs) in two neighbouring countries or countries within the same region.

Suggested Reading

1. John Daniels, Lee Radebaugh, Daniel Sullivan *International Business*, Pearson Education, New York.
2. Anant Kumar Sundaram and J, Stewart Black, *The International Business Environment: Text and Cases*, PHI, New Delhi
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SGOU

04 BLOCK

Regional Economic Integration

Block Content

Unit - 1 Regional Economic Integration

Unit - 2 WTO

Unit 1

Regional Economic Integration

Learning Outcomes

After completing this unit the learners will be able to:

- ◆ get an awareness on Regional integration
- ◆ describe various forms of economic integration
- ◆ learn various cross national co operation and agreements

Background

Regional economic integration is the process by which neighbouring countries work together to strengthen economic relations and integrate their economies using a variety of instruments such as trade agreements, customs unions, and economic communities. The major purpose of regional economic integration is to stimulate economic growth, increase competitiveness, and create regional development. By reducing trade obstacles, harmonising regulations, and easing the flow of products, services, capital, and labour across borders, regional economic integration strives to create a larger and more efficient market that benefits all participating countries. Such integration can result in higher investment flows, knowledge transfer, and economies of scale, all of which can help to drive growth and development. Furthermore, regional economic integration can deepen political relations, foster peace and stability, and increase the region's bargaining leverage in global trade talks. Regional economic integration also presents obstacles, such as reconciling diverse national interests, addressing economic development inequalities among member nations, and managing possible tensions resulting from increased rivalry and integration. Overall, regional economic integration is a multidimensional process that involves careful planning, coordination, and cooperation among participating countries in order to reach its full potential and maximise its benefits for long-term development.

Keywords

Regional economic integration, Preferential Trading Area, Free Trade Area, Customs Union, Common Market



4.1.1 Regional Economic Integration

In the era of globalization, the entire world is witnessing an integrated operation in all aspects of operations. Nobody can operate isolated that too for the long run. The operation of a business itself is a complicated thing in this modern world. If it is beyond the national boundaries, it means it will again need more strategies. To have better operations on the international platform, firms need to focus on many things or it may be determined by various factors. There is a vast difference between domestic and international business operations. The success and failure of a firm depend on various factors. If it is an internationally operating firm, economic integration is one of the major factors which determines its trading volume and reach.

◆ economic integration is a major factor

Economic integration is an arrangement among a group of nations who have a uniform approach to business and operations. This makes a favourable atmosphere for the member countries by the way of reduction or elimination of trade restrictions and favourable monetary and fiscal policies. These all liberalize the flow of goods, services, and various factors of production. These regional economic integrations are designed to promote free trade and generate gains from trade for all member economies. However, each member economy can have its trade policies concerning non-member economies. The monetary policy of a nation depends on the central bank's policy to enhance sustainable economic prosperity by using a set of economic tools by controlling the total supply of money in the economy. The systematic integration of all these between the nations will help to reduce the cost for the consumers as well as the manufacturers in the member countries.

◆ Helps to reduce cost

The agreements between these member countries will help international firms to promote trade in the cross-country trade and transitions. Economic integration is often referred to as regional integration as it often occurs among neighboring nations that share geographical boundaries. Regional integration allows distinct national economies to become economically linked and interdependent through greater cross-national movement of products, services, and factors of production. It allows member states to use resources more productively. The total output of the integrated bloc is generally greater than the summated output of the individual states.

◆ Regional integration keeps the nations economically linked and independent

When regional economies agree on integration, trade barriers fall, and economic and political coordination increases.

There are seven main stages in economic integration. They are pointed out below.

- ◆ A Preferential Trading Area,
- ◆ A Free Trade Area,
- ◆ A Customs Union,
- ◆ A Common Market,
- ◆ An Economic Union,
- ◆ An Economic and Monetary Union,
- ◆ And Complete Economic Integration.

The complete economic integration depicts the complete integration of fiscal policy and a complete monetary policy.

4.1.2 Costs of Economic Integration

Even though there are a lot of benefits economic integration has a lot of costs to be faced. These all can be put under three heads:

- ◆ **Division of Trade**

Economic integration will lead to a new entry into the system by allowing the nonmember countries to enter into the existing system, even if it is economically harmful to the members.

- ◆ **Erosion of national sovereignty**

The whole members of economic unions are normally required to adhere to rules on trade, monetary policy, and fiscal policies established by an unelected external policymaking body. This will lead to the erosion of national sovereignty in other countries.

Economic integration may lead to a lot of advantages for the member countries. Many factors can be taken as indicators to measure the impact of the same on the economy of the member countries. The methodology to measure the impact is based on the trade in goods and services, cross-border capital flows, labour migration, and other factors. Assessment of economic integration also includes measures of institutional conformity, such as membership in trade unions and the strength of institutions that protect consumer and investor rights. Integration of all these factors will lead to a uniformity of practices as well as the standardization of operations.

The trade agreements between the nations can be in two ways Bilateral trade agreements and multilateral trade agree-

◆ uniformity of practices and operations



ments. Trade focuses on the economic exchange of goods, services, and factors of production between two or more integrated countries. If it is bilateral, it will be between two nations and if it is among several countries, it will be a multilateral agreement.

4.1.3 Levels of Economic Integration

Basic classification of Economic integrations progresses from low-level integration to higher levels of integration with the growth of trade and investment. There are FIVE levels of economic integration starting from the lower level of the preferential trade agreement to a deeper level of political union.

4.1.4 Preferential Trade Area

A Preferential Trade Area (PTA) is a type of economic integration where member countries agree to reduce tariffs and other trade barriers on specific products imported from other member countries, without eliminating all trade barriers. This form of integration is less comprehensive than a Free Trade Area (FTA) or a Customs Union, as it offers preferential access to certain goods and services rather than a complete removal of trade restrictions. PTAs promote increased trade between member countries by lowering tariffs on selected goods, fostering closer economic ties and cooperation. They offer flexibility and require less commitment compared to more advanced levels of integration, making them attractive for countries seeking to enhance trade relationships without extensive policy coordination. By providing better market access, PTAs benefit exporters and consumers through increased availability of goods and competitive pricing, and can help diversify export markets, reducing dependence on a limited number of trading partners. However, PTAs also face challenges such as limited trade benefits due to their restricted product coverage, complex rules of origin for determining eligibility for preferential treatment, and potential trade diversion, where trade shifts from more efficient non-member producers to less efficient member producers. Examples of PTAs include the Common Market for Eastern and Southern Africa (COMESA) and the SAARC Preferential Trading Arrangement (SAPTA), which aim to promote regional integration and trade among their member countries.

◆ reduce or eliminate the tariff barriers

4.1.5 The Free Trade Area

It is the simplest and most common arrangement, in which member countries agree to gradually eliminate formal barriers to trade in products and services within the bloc, while each member country maintains an independent international trade policy with countries outside the bloc. NAFTA is an example. The free trade area emphasizes the pursuit of comparative advantage for

◆ eliminate formal barriers

a group of countries rather than for individual states. Governments may impose local content requirements, which specify that producers located within the member countries provide a certain proportion of products and supplies used in local manufacturing. If the content requirement is not met, the product becomes subject to the tariffs that member governments normally impose on nonmember countries.

◆ Common external tariff on imports

4.1.6 Customs Union

The customs union is a level of regional integration, similar to a free trade area except that member states harmonize their external trade policies and adopt common tariff and nontariff barriers on imports from nonmember countries. In other words, a customs union is an agreement between two or more countries to remove trade barriers and lower or eliminate tariffs. Members of a customs union generally apply a common external tariff on imports from non-member countries. MERCOSUR is the best example for the same. It is an economic bloc in Latin America. Argentina, Brazil, Paraguay, and Uruguay are the member countries of this bloc. This system allows an exporter outside MERCOSUR to have to transact the same tariff and nontariff barriers when they trade with any other countries, who are not the member of MERCOSUR. Determining the most appropriate common external tariff is challenging because member countries must agree on the percentage level of the tariff and on how to distribute proceeds from the tariff among the member countries.

Purpose of Customs Unions

The purpose of a customs union is to make it easier for member countries to trade freely with one another. The union reduces the administrative and financial burden of barrier trading and fosters economic cooperation among nations. However, member countries are not given the freedom to form their own trade deals. The countries in the customs union usually restructure their domestic economy and economic policies in order to maximize their gain from membership in the union. The European Union is the largest customs union in the world in terms of the economic output of its members. A customs union generates trade creation and diversion that helps with economic integration. Below are the advantages and disadvantages of customs unions.

Advantages of Custom Unions

Customs unions offer the following benefits:

1. Increase in trade flows and economic integration

The main effect of a free-trade agreement is that it increases trade among member countries. It helps improve the allocation of scarce resources that satisfy the wants and needs of

consumers and boosts foreign direct investment (FDI). Customs unions lead to better economic integration and political cooperation among nations and the creation of a common market, monetary union, and fiscal union.

2. Trade creation and trade diversion

The effectiveness of a customs union is measured in terms of trade creation and trade diversion. Trade creation occurs when the more efficient members of the union sell to less efficient members, leading to a better allocation of resources. Trade diversion occurs when efficient non-member countries sell fewer goods to member countries because of external tariffs. It gives less efficient countries in the union the opportunity to capitalize on their position and sell more goods within the union. If the gains from trade creation exceed the losses from trade diversion, that leads to increased economic welfare among member countries.

3. Reduces trade deflection

One of the main reasons a customs union is favoured over a free trade agreement is that the former solves the problem of trade deflection. This occurs when a non-member country sells its goods to a low-tariff FTA (free trade agreement) country, which then resells to a high-tariff FTA country, leading to trade distortions. The presence of a common external tariff in customs unions helps avoid problems that arise from tariff differentials.

4.1.7 Common Market

A common market, or single market, is an economic system where multiple countries eliminate trade barriers and harmonize regulations to facilitate the free movement of goods, services, capital, and labor, thereby enhancing economic cooperation and growth. This integration allows products to flow seamlessly across borders, enables service providers to operate without significant regulatory hurdles, and permits financial markets to integrate for improved resource allocation. It also allows workers to move freely between member countries, addressing labour shortages and providing more opportunities. The harmonization of policies, such as product safety, environmental standards, and consumer protection, ensures a level playing field and reduces regulatory complexity. The benefits include economic growth, consumer access to a wider variety of goods and services at lower prices, increased investment opportunities, and enhanced economic stability through coordinated policies. However, challenges include aligning regulations across different legal systems and economic structures, managing economic disparities between member states, addressing concerns about loss of sovereignty, and ensuring effective implementation and enforcement of common market regulations.

◆ multiple countries eliminate trade barriers

4.1.8 Economic Union

An economic union is one of the different types of trade blocs. It refers to an agreement between countries that allow products, services, and workers to cross borders freely. The union aims at eliminating internal trade barriers among the member countries, with the goal of economically benefiting all the member countries. It's a deeper level of integration. Along with the advantages of earlier stages of integration member economies also agree to have a common monetary and fiscal policy including identical tax rates, fixed exchange rates, free convertibility of currencies, and free movement of capital. The more similar the economies of the member countries, the more likely that the economic bloc will succeed. Large wage rate differences mean workers in lower-wage countries will migrate to higher-wage countries. Economic instability in one member country can spread quickly and harm the economies of the other members. Compatibility of economic characteristics is so important that the EU requires its current and prospective members to meet strict membership conditions, ideally low inflation, low unemployment, reasonable wages, and stable economic conditions. The bloc aims for standardized monetary policy, which requires establishing fixed exchange rates and free convertibility of currencies among the member states, in addition to allowing the free movement of capital. This standardization helps eliminate discriminatory practices that might favor one member state over another. Through greater mobility of products, services, and production factors, an economic union enables firms within the bloc to locate productive activities in member states with the most favourable economic policies.

◆ Deep Integration

The EU has made great strides toward achieving an economic union. For example, seventeen EU countries have established a monetary union in which a single currency, the euro, is now in circulation. The monetary union and the euro have greatly increased the ease with which European financial institutions establish branches across the Eu and offer banking services, insurance, and savings products. The single currency also makes trading and investment easier for European firms doing business within the union.

◆ single currency

To achieve greater economic integration, economic union member countries strive to eliminate border controls, harmonize product and labeling standards, and establish region-wide policies for energy, agriculture, and social services. An economic union also requires its member to standardize laws and regulations regarding competition, mergers, and other corporate behaviors. To facilitate free trade in services, member

◆ Free Movement for professional also



countries harmonize procedures for licensing of professionals so that a doctor or lawyer qualified in one country can practice in any other country.

The United States provides a good analogy for an economic union. Imagine each state is like an individual country, but all are joined together in a union. The members have a common currency and a single central bank with a uniform monetary policy. Trade among the members takes place unobstructed, and both labor and capital move freely among them. The federal government applies a uniform tax and fiscal policy. Just as would occur in an economic union, the individual U.S. states also govern themselves in such areas as education, policy protection, and local taxes. This analogy only goes so far, of course. The United State is a country and, unlike members of a real economic union, the states cannot withdraw.

4.1.9 Political Union

A political union is a type of political entity which is composed of, or created from smaller polities, or the process which achieves this. These smaller polities are federated states in a federal government, or provinces in a centralized government. The similarity in political systems enhances prospects for a successful block. Countries that seek to integrate regionally should share similar aspirations and a willingness to surrender national autonomy for the larger goals of the proposed union. For example, most of the existing EU members are characterized by a long history of stable, socially democratic forms of government. By contrast, many Europeans have been reluctant to allow Ukraine to enter the EU, partly due to the country's history of socialism and political turmoil.

This form of government may be voluntary and mutual and is described as unionism by its constituent members and proponents. In other cases, it may arise from political unification, characterised by coercion and conquest. The unification of separate states which, in the past, had together constituted a single entity, is known as reunification. Unlike a personal union or real union, the individual constituent entities may have devolution of powers but are subordinate to a central government or coordinated in some sort of organization. In a federalized system the constituent entities usually have internal autonomy and share power with a federal government, for whom external sovereignty, military forces, and foreign affairs are usually reserved. The union is recognized internationally as a single political entity. A political union may also be called a legislative union or state union.

4.1.10 Trade Creation and Diversion Effects

Trade Creation occurs when the formation of a free trade area or customs union leads to an increase in trade between

◆ Political integration

◆ legislative union

member countries. This happens because tariffs and other trade barriers are eliminated within the bloc, making it more attractive for countries to trade with each other. As a result, goods and services are produced where they have a comparative advantage, leading to increased efficiency and lower prices for consumers. For instance, if Country A is more efficient in producing cars while Country B is better at producing agricultural products, a free trade agreement between them would encourage specialization and trade, benefiting both economies.

Trade Diversion, on the other hand, refers to the shift of trade from more efficient producers outside the trade bloc to less efficient producers within the bloc. This occurs when tariffs are reduced or eliminated for member countries but maintained or increased for non-member countries. Consequently, consumers may end up paying higher prices for less competitive products from within the bloc compared to what they could have obtained from more efficient producers outside the bloc. For example, if Country C is the most efficient producer of textiles globally, but it is not a member of the free trade area between Countries A and B, trade diversion might occur if Country A or B starts producing textiles at a higher cost due to reduced competition.

4.1.11 Cross National Cooperation and Agreements

Cross-national cooperation and agreements involve countries collaborating on various economic, political, and social issues to achieve mutual benefits and address common challenges. These agreements can take various forms, such as trade agreements, environmental accords, and security pacts, aiming to enhance cooperation and foster stability. Trade agreements, like free trade areas and customs unions, reduce tariffs and trade barriers, promoting economic growth and integration. Environmental agreements, such as the Paris Agreement, coordinate efforts to combat climate change and protect natural resources. Security pacts, like NATO, ensure collective defense and political stability. Cross-national cooperation helps countries leverage shared resources, knowledge, and technology, leading to improved economic efficiency, innovation, and sustainable development. Such agreements also facilitate diplomatic relations, reduce conflicts, and build frameworks for addressing global issues collaboratively, reflecting the interconnected nature of today's world.

4.1.12 Nafta

NAFTA, the North American Free Trade Agreement, stands as one of the most significant trade agreements in modern his-

tory. Enacted in 1994, it brought together three major North American economies: the United States, Canada, and Mexico, in a comprehensive trade pact aimed at fostering economic integration and growth. Its impact spans multiple dimensions, from economics to politics and even cultural exchange. Economically, NAFTA eliminated tariffs on most goods traded among the member countries over a fifteen-year period, facilitating a surge in cross-border trade. This resulted in a dramatic increase in the volume of trade among the three nations. Mexico, in particular, experienced notable growth, with its manufacturing sector benefiting from increased investment and access to the vast U.S. market. The agreement also stimulated job creation in certain industries, while simultaneously reshaping others due to increased competition. NAFTA sparked a wave of cross-border investment, as companies sought to capitalize on the newfound opportunities for expansion and efficiency gains. This led to the establishment of integrated supply chains across North America, with goods often crossing borders multiple times during the production process. Such integration not only bolstered economic ties but also deepened interdependence among the member states.

4.1.13 The European Union (EU)

The European Union (EU) is a political and economic union of 27 member countries primarily located in Europe. Established through a series of treaties, the EU aims to foster economic cooperation, promote peace, and ensure the free movement of people, goods, services, and capital among its members. The EU has developed a single market, which allows for tariff-free trade across member states, and has adopted common policies in areas such as agriculture, fisheries, regional development, and competition. 20 of the member countries have adopted the euro as their official currency, forming the Eurozone. The EU operates through a complex institutional framework that includes the European Commission, the European Parliament, the Council of the European Union, and the European Court of Justice, each playing a role in legislation, policy implementation, and judicial review. The EU also engages in diplomatic efforts and maintains a significant presence in global trade and environmental agreements. Despite its successes, the EU faces challenges such as political fragmentation, economic disparities between member states, and managing relations with neighbouring countries and global powers. Issues like Brexit, the migration crisis, and the economic impact of the COVID-19 pandemic have tested the union's cohesion and resilience. Nonetheless, the EU remains a unique example of regional integration, striving to balance national sovereignty with the benefits of collective action, and continues to play a crucial role in shaping the economic and political land-

scape of Europe and beyond.

4.1.14 SAARC

The South Asian Association for Regional Cooperation (SAARC) is a regional intergovernmental organization comprising eight South Asian countries: Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. Established in 1985, SAARC aims to promote regional cooperation and development in various areas such as trade, economics, culture, and technology. Economically, SAARC seeks to enhance intra-regional trade and investment among its member states. Efforts to establish a South Asian Free Trade Area (SAFTA) have faced challenges, including non-tariff barriers and political conflicts, hindering the realization of the full potential for economic integration within the region. Beyond trade, SAARC also endeavours to address common challenges faced by its member states, including poverty alleviation, food security, environmental sustainability, and disaster management. Cooperation in these areas has led to the development of various regional initiatives and mechanisms, such as the SAARC Food Bank, the SAARC Disaster Management Centre, and the SAARC Development Fund.

4.1.15 ASEAN

The Association of Southeast Asian Nations (ASEAN) is a regional intergovernmental organization established on August 8, 1967, by Indonesia, Malaysia, the Philippines, Singapore, and Thailand. Since its inception, ASEAN has grown to include ten member states, with Brunei Darussalam, Vietnam, Laos, Myanmar, and Cambodia joining subsequently. The organization is built on the principles of mutual respect, non-interference in internal affairs, and consensus-based decision-making. Economically, ASEAN has made significant strides in promoting regional integration and cooperation. The establishment of the ASEAN Free Trade Area (AFTA) in 1992 aimed to create a single market and production base, facilitating the flow of goods, services, and investments within the region. This has led to the formation of supply chains and increased intra-regional trade, contributing to economic growth and development among member states.

ASEAN has pursued deeper economic integration through initiatives such as the ASEAN Economic Community (AEC), which aims to create a single market and production base with free movement of goods, services, investments, and skilled labour. While progress towards achieving the AEC's goals has been gradual, it represents a significant step towards realizing the region's economic potential and enhancing its com-

◆ Economic integration and promoting peace



petitiveness on the global stage. ASEAN plays a crucial role in promoting peace, stability, and security in Southeast Asia. The organization has established mechanisms for conflict prevention, resolution, and confidence-building among member states, such as the ASEAN Regional Forum (ARF) and the Treaty of Amity and Cooperation (TAC). These efforts have helped to mitigate tensions and foster cooperation in addressing regional security challenges, including maritime disputes and transnational crime.

Summarised Overview

Regional Economic Integration refers to various levels of collaboration among neighbouring countries to strengthen economic links and generate mutual advantages. It starts with Preferential Trade Areas (PTAs), in which member countries lower tariffs on certain items traded among themselves. Free Trade Areas (FTAs) go a step further by abolishing tariffs on most items sold inside the territory, resulting in increased trade flows and efficiency advantages. Customs Unions advance integration by harmonising external tariffs and developing a uniform trade policy with non-member nations. Common markets strengthen integration by permitting the free movement of commodities, services, capital, and labour among member nations. Economic unions require the harmonisation of economic policies, particularly fiscal and monetary policies, in order to achieve greater integration. Political Unions are the most advanced stage of integration, requiring the development of common political structures and decision-making bodies. Regional integration efforts result in trade creation, where more efficient manufacturers inside the region replace less efficient ones, and trade diversion, when member countries redirect trade away from more efficient producers outside the region. Cross-national cooperation and agreements, such as NAFTA in North America, the EU in Europe, SAARC in South Asia, and ASEAN in Southeast Asia, represent various models and stages of regional economic integration, each with its own set of challenges and opportunities for economic growth, development, and political collaboration.

Self-Assessment questions

1. What is a Preferential Trade Area (PTA), and how does it differ from a Free Trade Area (FTA)?
2. Define a Customs Union and explain how it differs from a Common Market.
3. What are the key features of a Common Market, and what benefits does it offer to member countries?
4. Describe the concept of an Economic Union and provide examples of Economic Unions around the world.
5. What distinguishes a Political Union from other forms of regional economic integration?

6. Explain the concepts of trade creation and trade diversion effects in the context of regional economic integration.
7. How do Preferential Trade Areas (PTAs) contribute to cross-national cooperation and agreements?
8. Provide examples of Preferential Trade Areas (PTAs) and discuss their impact on trade and economic development.
9. Analyze the objectives and achievements of the North American Free Trade Agreement (NAFTA).
10. What are the main goals of the European Union (EU), and how has it evolved over time?
11. Discuss the role of the South Asian Association for Regional Cooperation (SAARC) in promoting regional economic integration and cooperation.

Assignments

1. Write an essay analyzing the evolution and impact of Regional Economic Integration initiatives such as NAFTA, EU, SAARC, and ASEAN. Evaluate their objectives, achievements, challenges, and implications for member countries and global trade dynamics.
2. Select a specific regional economic integration agreement (e.g., EU, NAFTA, ASEAN) and conduct a case study examining its implementation and outcomes. Analyze the factors contributing to its success or failure, and assess its impact on member countries' economies, trade patterns, and political relations.
3. Compare and contrast different levels of regional economic integration, such as Preferential Trade Areas, Free Trade Areas, Customs Unions, and Common Markets.
4. Evaluate the effectiveness of existing regional economic integration policies and initiatives in achieving their stated objectives. Identify gaps, inefficiencies, and areas for improvement, and propose policy reforms or adjustments to enhance the efficiency and inclusiveness of integration efforts.
5. Explore the linkages between regional economic integration and sustainable development goals (SDGs). Analyze how integration initiatives impact environmental sustainability, social inclusion, and economic resilience in member countries.
6. Select a case study of successful cross-border cooperation and economic integration among neighboring countries. Investigate the factors contributing to successful integration, such as political will, institutional capacity, and civil society engagement.

Suggested Reading

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9. Sumati, V.(2011). International Business. Ane Books Pvt Ltd, New Delhi..
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Space for Learner Engagement for Objective Questions

Learners are encouraged to develop objective questions based on the content in the paragraph as a sign of their comprehension of the content. The Learners may reflect on the recap bullets and relate their understanding with the narrative in order to frame objective questions from the given text. The University expects that 1 - 2 questions are developed for each paragraph. The space given below can be used for listing the questions.

SGOU



Unit 2

WTO

Learning Outcomes

After completing this unit the Learner will be able to

- ◆ get an awareness of the principles and functions of WTO
- ◆ distinguish between WTO and GATT
- ◆ learn about the functions of IMF and IBRD

Background

The World Trade Organisation (WTO) is in the centre of the global economic landscape, serving as a light of international collaboration and trade governance. The WTO, founded on the principles of nondiscrimination, reciprocity, and transparency, is the core of the multilateral trading system, creating a rules-based framework that promotes open, fair, and predictable commercial interactions among its member countries. The WTO enables the smooth flow of commerce across borders through a slew of agreements covering trade in products, services, and intellectual property, while protecting the interests of both established and developing countries. Unlike its predecessor, the General Agreement on Tariffs and Trade (GATT), the WTO has a broader scope and stronger institutional procedures, allowing it to confront new challenges and adapt to changing economic realities. In collaboration with other trade-related institutions such as the United States Conference on Trade and Development (UNCTAD), the WTO works to promote inclusive and sustainable development, ensuring that the advantages of global trade are dispersed equally across states and regions. Against the backdrop of the Bretton Woods system, which gave rise to institutions such as the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD), the WTO plays a critical role in shaping the contours of the modern global economic order, encouraging cooperation and coordination among nations while attempting to address the multifaceted challenges of the twenty-first century. Along with regional development banks such as the Asian Development Bank (ADB), the World Trade Organisation (WTO) is a cornerstone of international economic governance, working relentlessly to promote prosperity, stability, and shared prosperity worldwide.

Keywords

WTO, GATT, UNCTAD, Bretton Woods system

Discussion

4.2.1 The World Trade Organization (WTO)

WTO is the international organization which monitors the global trade among nations. It was introduced to meet the changing needs of the world trade which was then monitored by GATT. Currently it is the only institution globally regulating and monitoring the trade among nations. The WTO ensures the free flow of trade among nations. World's trading nations come together and sign agreements and ratify the same in their parliaments. These agreements ensure the free flow of trade, predictably and effortlessly. Majority of the world's nations are part of WTO. It acts as a guardian angel to the exporters, importers and manufacturers who indulge in international trade. As of 2022, the WTO has 164 member countries.

WTO plays a variety of roles in the world economy. It formulates the rules for world trade. It provides the platform for negotiating trade agreements where the WTO mediates between the members and extends support to developing countries. All major decisions are made by the WTO's member governments: either by ministers (who usually meet at least every two years) or by their ambassadors or delegates (who meet regularly in Geneva). The WTO is essentially an alternative dispute or mediation entity that upholds the international rules of trade among nations. The organization provides a platform that allows member governments to negotiate and resolve trade issues with other members. The WTO's main focus is to provide open lines of communication concerning trade among its members. Fundamental principles form the foundation of the multilateral trading system. The primary purpose of the WTO is to open trade for the benefit of all.

- ◆ Formulates World trade rules

4.2.2 Basic Principles of WTO

The World Trade Organization (WTO) is the global international organization that deals with the rules of trade between nations. It operates on several fundamental principles that guide its policies and practices, aiming to promote smooth, predictable, and fair trade relations among its member countries.

1. Non-Discrimination:

One of the core principles of the WTO is non-discrimination, which is primarily embodied in two key rules: Most-Favored-Nation (MFN) treatment and National Treatment. MFN treatment requires that countries do not discriminate between their trading partners. This means any advantage, favor, privilege, or immunity granted by a country to one WTO member must be immediately and unconditionally extended to all other WTO members. The purpose is to ensure that all WTO members receive equal treatment and benefits in international trade relations, promoting fairness and preventing trade discrimination. National Treatment, on the other hand, ensures that imported and locally-produced goods and services are treated equally once they have entered the market. This principle prohibits discrimination between foreign and domestic products or services, ensuring that foreign goods are not subjected to less favourable treatment than domestic goods once they enter a country's market. Both MFN and National Treatment principles contribute to creating a more open and predictable trading environment, reducing barriers to trade and encouraging economic integration among WTO members.

2. Free Trade:

The WTO promotes free trade by encouraging its members to reduce trade barriers such as tariffs, quotas, and subsidies through negotiations and agreements. The reduction of these barriers aims to facilitate the flow of goods and services across borders, leading to increased trade volumes and economic growth. Free trade principles also promote efficiency in resource allocation, as countries can specialize in producing goods and services in which they have a comparative advantage, benefiting from lower production costs and higher productivity.

3. Predictability and Transparency:

Another fundamental principle of the WTO is predictability and transparency in trade policies and practices. WTO members are required to notify the organization about their trade policies and practices and provide timely information on changes. This transparency ensures that trading partners are aware of each other's trade measures, reducing uncertainty and allowing businesses to make informed decisions. Predictability in trade rules and regulations also promotes confidence among traders and investors, contributing to a stable and conducive business environment.

4. Fair Competition:

The WTO promotes fair competition by establishing rules that govern trade practices and prohibit unfair trade practices that

distort competition. For instance, the WTO Agreement on Subsidies and Countervailing Measures regulates the use of subsidies by governments, aiming to prevent subsidies that distort international trade and adversely affect other WTO members. The Agreement also provides rules for countervailing measures that countries can take to offset the adverse effects of subsidized imports.

5. Promotion of Development:

While promoting trade liberalization, the WTO recognizes the differing levels of development among its member countries. Special and differential treatment provisions allow developing countries more flexibility and longer timeframes to implement WTO agreements, taking into account their development needs and capacities. The WTO also provides technical assistance and capacity-building programs to help developing countries benefit from trade opportunities and integrate into the global economy effectively.

4.2.3 Various Agreements

The World Trade Organization (WTO) administers various agreements that cover a wide range of trade-related issues, aimed at promoting international trade and economic cooperation among its member countries. These agreements are legally binding and set out rules and principles that govern global trade relations. Here are some key WTO agreements:

1. General Agreement on Tariffs and Trade (GATT):

GATT is one of the oldest agreements under the WTO framework, originally established in 1947 and subsequently updated through several rounds of negotiations. Its primary objective is to reduce barriers to international trade, such as tariffs and quotas. GATT principles, such as most-favoured-nation (MFN) treatment and national treatment, form the foundation of non-discriminatory trade practices among member countries.

2. Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS):

TRIPS, established in 1994, sets out minimum standards for the protection of intellectual property rights (IPRs) globally. It aims to ensure that countries have effective and enforceable IPR regimes that encourage innovation and creativity while allowing fair access to technological advancements.

3. Agreement on Trade-Related Investment Measures (TRIMS):

TRIMS addresses trade-distorting measures that affect investment, such as local content requirements and trade balanc-

ing requirements imposed by governments. It prohibits WTO members from adopting certain types of investment-related measures that distort trade or create barriers to market access.

4. Agreement on Agriculture (AoA):

The AoA, negotiated during the Uruguay Round, aims to reform agricultural trade policies and reduce distortions in the global agricultural market. It addresses issues such as subsidies, market access for agricultural products, and export competition, with the goal of achieving fairer and more market-oriented agricultural trade practices.

5. Agreement on Sanitary and Phytosanitary Measures (SPS Agreement):

The SPS Agreement sets out rules and guidelines for food safety and animal and plant health standards in international trade. It allows countries to adopt measures to protect human, animal, or plant life or health, while ensuring these measures are based on scientific principles and do not unjustifiably restrict trade.

6. Agreement on Technical Barriers to Trade (TBT Agreement):

The TBT Agreement aims to ensure that technical regulations, standards, and conformity assessment procedures do not create unnecessary obstacles to trade. It encourages transparency and harmonization of technical regulations and standards to facilitate trade while protecting legitimate objectives, such as consumer health and safety.

4.2.4 Functions And Areas of WTO

The World Trade Organization (WTO) serves as the global international organization that deals with the rules of trade between nations. It operates on the principles of non-discrimination, transparency, and the promotion of free trade. The WTO has several functions and areas of focus:

Negotiation of Trade Agreements

One of the primary functions of the WTO is to negotiate and facilitate trade agreements among its member countries. These agreements aim to reduce trade barriers such as tariffs and quotas, and address issues related to trade in goods, services, and intellectual property

Dispute Settlement

The WTO provides a forum for resolving disputes between member countries regarding the interpretation and application of trade agreements. Its dispute settlement mechanism is a key

function of the organization, ensuring that trade disputes are resolved in a fair and transparent manner.

Monitoring and Implementation

The WTO monitors the implementation of trade agreements and ensures that member countries comply with their commitments. It also provides technical assistance and capacity-building support to help countries implement trade-related reforms and meet their obligations under WTO agreements.

Trade Policy Review

The WTO conducts regular reviews of member countries' trade policies and practices through its Trade Policy Review Mechanism (TPRM). These reviews provide valuable information on countries' trade policies and help to promote transparency and accountability in the global trading system.

Assistance for Developing Countries

The WTO provides technical assistance and support to help developing countries participate more effectively in the global trading system. This includes capacity-building initiatives, training programs, and support for trade-related infrastructure development.

Promotion of Fair Trade Practices

The WTO promotes fair and non-discriminatory trade practices among its member countries. It works to prevent unfair trade practices such as dumping, subsidies, and discriminatory measures that distort international trade.

Trade and Environment

The WTO addresses the relationship between trade and environmental protection, aiming to ensure that trade policies and environmental measures are mutually supportive. It encourages member countries to pursue sustainable development and environmental conservation while promoting trade liberalization.

Trade and Development

The WTO recognizes the importance of trade in promoting economic development and poverty reduction. It works to integrate developing countries into the global trading system and promote inclusive growth through trade.

4.2.5 Pre WTO-Scenario

Before the establishment of the World Trade Organization (WTO), the global trading system was governed by various agreements negotiated under the General Agreement on Tariffs and Trade (GATT) framework. GATT, created in 1947, served



as a multilateral agreement aimed at promoting international trade by reducing tariffs and other barriers to trade.

During the pre-WTO era, the global trading system was characterized by several key features:

Bilateral and Multilateral Agreements:

Trade negotiations primarily took place on a bilateral or plurilateral basis, with countries negotiating trade agreements with each other to reduce tariffs and promote trade. The GATT provided a framework for multilateral negotiations among its member countries.

Tariff Reductions

The primary focus of trade negotiations under GATT was on reducing tariffs on industrial goods. Successive rounds of negotiations, such as the Kennedy Round (1964-1967) and the Tokyo Round (1973-1979), resulted in significant tariff reductions among GATT member countries.

Limited Scope

The GATT initially focused primarily on trade in goods, with limited provisions for addressing trade in services and intellectual property rights. As a result, trade negotiations often excluded these sectors, leading to gaps in the international trading system.

Dispute Settlement

The GATT provided a rudimentary mechanism for resolving disputes between member countries, but it lacked the enforcement mechanisms and legal framework of the WTO's dispute settlement mechanism. Disputes were often resolved through bilateral negotiations or arbitration.

Limited Institutional Framework

The GATT lacked a permanent institutional structure to oversee and enforce trade agreements. Instead, it operated through periodic ministerial conferences and ad hoc committees, which limited its effectiveness in addressing emerging trade issues and disputes.

Developing Country Concerns

Developing countries often felt marginalized in trade negotiations under the GATT, as negotiations tended to be dominated by industrialized countries. Many developing countries argued for greater consideration of their development needs and concerns in trade negotiations.

4.2.6 General Agreement on Tariffs and Trade (GATT)

After the world war and allied issues in the global scenario, there was a suggestion to create an organization aiming at post

◆ Formation of GATT

world war reconstruction and establishment of a new balance in the world trade. This organization was supposedly termed as the International Trade Organization, the ITO. ITO was planned along with other international monetary and trade institutions like the International Monetary Fund (IMF) and the World Bank. The UN Conference on Trade and Employment conducted at Havana in 1948 drafted the Havana Charter which was the backbone of ITO. It included the guidelines regarding the functioning of ITO. But the US Failed to ratify the agreement. At the same time other 23 countries were negotiating on the existing quotas, tariffs and trade among them. These 23 countries came to consensus on different terms. This led to the formation of GATT in Geneva in 1947. GATT Agreement came into force as the GATT on January 1, 1948. The GATT set of multilateral trade agreements aimed at the abolition of quotas and the reduction of tariff duties among the contracting nations. When the GATT nations conducted the meet it was considered as an interim agreement. It was considered that when the UN comes with the ITO, GATT will be dispersed.

When ITO failed to emerge, GATT gained prominence and enlarged. GATT was instrumental at several succeeding negotiations. In the coming years GATT proved to be the most effective instrument of world trade liberalization by accelerating and massively expanding the global trade. In the year 1995 GATT was replaced by the World Trade Organization (WTO). When it was dissolved 125 nations were signatories to its agreements, which contributed to 90 percent of world trade.

◆ GATT governed global trade

GATT, governed international trade for 47 years, overseeing commerce among 130 countries. It ensured equal market access among members, extending tariff reductions to all once agreed with major trading partners. GATT prioritized tariff protection over quotas, aiming to eliminate quantitative restrictions systematically. It established uniform customs regulations and mandated tariff negotiations upon request. An escape clause allowed nations to adjust terms if domestic producers suffered undue harm from trade concessions. Originally intended as an interim measure until the creation of the WTO, GATT evolved through supplementary codes, interpretations, and dispute resolutions. Despite the ITO never materializing, GATT effectively regulated global trade until the late 1980s. The economic changes of that era necessitated a stronger organization, culminating in the Uruguay Round's conclusion and the establishment of the WTO on January 1, 1995.

4.2.7 Differences between GATT and WTO

The points given below explain the difference between GATT and WTO in detail:

1. GATT refers to an international multilateral treaty, signed by 23 nations to promote international trade and remove cross-country trade barriers. On the contrary, WTO is a global body, which superseded GATT and deals with the rules of international trade between member nations.
2. While GATT is a simple agreement, there is no institutional existence, but has a small secretariat. Conversely, WTO is a permanent institution along with a secretariat.
3. The participating nations are called contracting parties in GATT, whereas for WTO, they are called member nations.
4. GATT commitments were provisional in nature, and after 47 years the government could make a choice to treat it as a permanent commitment or not. On the other hand, WTO commitments have been permanent, since the very beginning.
5. The scope of WTO is wider than that of GATT in the sense that the rules of GATT are applied only when the trade is made in goods. As opposed to it, WTO's rules are applicable to services and aspects of intellectual property along with the goods.
6. GATT agreement is primarily multilateral, but a plurilateral agreement is added to it later. In contrast, WTO agreements are purely multilateral.
7. Domestic legislation is allowed to continue in GATT, while the same is not possible in the case of WTO.
8. The dispute settlement system of GATT was slower, less automatic and susceptible to blockages unlike WTO, whose dispute settlement system is very effective.

4.2.8 The WTO and United Nations Conference on Trade and Development

The WTO and UNCTAD are parties in a strategic partnership for the purpose of implementing the DDA, cooperating to ensure that trade serves development goals, and for assisting the beneficial integration of the developing and least developed countries (LDCs) into the global economy and the multilateral trading system. In order to deepen and give practical effect to this strategic partnership WTO and UNCTAD on 16 April 2003 signed a Memorandum of Understanding (MoU), This understanding provides a legal framework that identifies more clearly the partner's fields of cooperation and facilitates their joint activities.

Joint Activities

The Integrated Framework for Trade-related Technical As-

sistance (IF) and the Joint Integrated Technical Assistance Programme (JITAP) are examples of partnership initiatives where WTO and UNCTAD are core partner agencies working together with a view to increasing the participation of LDCs in the multilateral trading system (MTS). UNCTAD is also an observer to the Standards and Trade Development Facility (STDF) Working Group and Policy Committee as of March 2007. It is also serving as executing agency for selected STDF projects.

The Integrated Framework (IF)

The IF is a process that was established to support LDC governments in trade capacity building and integrating trade issues into overall national development strategies. UNCTAD is one of the six core agencies of the IF. Along with the core agencies, UNCTAD joins other development partners to respond to the trade development needs of LDCs. UNCTAD is an active member of the management structure of the IF, and has been participating in all stages of the IF process. UNCTAD provides assistance at the policy level using its research and policy analysis capacity.

The Joint Integrated Technical Assistance Programme (JITAP)

The Joint Integrated Technical Assistance Programme (JITAP) is a collaborative initiative by the International Trade Centre (ITC), the United Nations Conference on Trade and Development (UNCTAD), and the World Trade Organization (WTO) designed to enhance the trade capacities of African countries. Launched in 1998, JITAP aims to support beneficiary countries in integrating into the global economy by providing technical assistance, training, and capacity-building to improve their understanding of and compliance with international trade rules. It focuses on enhancing institutional and human resource capacities, fostering better trade policy formulation, and enabling effective participation in multilateral trade negotiations. By strengthening the ability of these countries to leverage trade opportunities, JITAP seeks to promote economic growth, reduce poverty, and achieve sustainable development. The program is instrumental in addressing trade-related challenges and empowering African countries to benefit more effectively from the global trading system.

Aid for Trade

The IF and JITAP are specific examples of Aid for Trade - a much wider initiative aimed at helping developing countries, and the least-developed in particular, to build the supply side capacity and trade-related infrastructure they need to benefit



more from trade opening and the WTO. Here too the WTO and UNCTAD are strategic partners. UNCTAD is one of the key international organizations represented on the Director-General's Advisory Group on Aid for Trade, where it is making an important contribution to the WTO's efforts to better mobilize, monitor and evaluate Aid for Trade.

Other Activities

WTO Committees, such as the Committee on Trade and Development (CTD) and the Sub-Committee on Least-Developed Countries, provide a forum for information exchange on the developmental and technical assistance activities undertaken by other multilateral organizations, including UNCTAD. In the CTD, for instance, UNCTAD has frequently contributed to the work of the WTO by making presentations on its work and research related to commodities trade. UNCTAD also reports occasionally to the LDCs on their activities undertaken in favour of LDCs, in particular activities that support the diversification of LDCs' production and export base. UNCTAD is an observer in the Working Group on Trade and Transfer of Technology and has contributed a number of valuable studies, including national case studies. The Members of the Working Group will continue to work closely with UNCTAD in their work to study and explore further the various crucial factors and actors influencing the flow of technology among countries.

Participation of WTO in UNCTAD's activities

The WTO follows and participates, as an observer, in the meetings of the UN Commission on Science, Technology and Development and UNCTAD's Commission on Investment, Technology and Related Financial Issues, and other related Expert Group meetings. The WTO is also represented at UNCTAD's Trade and Development Board, as well as at the Commission on Trade in Goods and Services, and Commodities. The WTO also attends the annual Joint Advisory Group on the International Trade Centre UNCTAD/WTO.

The Bretton Woods Agreement was negotiated in July 1944 by delegates from 44 countries at the United Nations Monetary and Financial Conference held in Bretton Woods, New Hampshire. Hence, the name "Bretton Woods Agreement. Under the Bretton Woods System, gold was the basis for the U.S. dollar and other currencies were pegged to the U.S. dollar's value. The Bretton Woods System effectively came to an end in the early 1970s when President Richard M. Nixon announced that the U.S. would no longer exchange gold for U.S. currency.

Approximately 730 delegates representing 44 countries met in Bretton Woods in July 1944 with the principal goals of creat-

◆ Bretton Woods Agreement

ing an efficient foreign exchange system, preventing competitive devaluations of currencies, and promoting international economic growth. The Bretton Woods Agreement and System were central to these goals. The Bretton Woods Agreement also created two important organizations—the International Monetary Fund (IMF) and the World Bank. While the Bretton Woods System was dissolved in the 1970s, both the IMF and World Bank have remained strong pillars for the exchange of international currencies. Though the Bretton Woods conference itself took place over just three weeks, the preparations for it had been going on for several years. The primary designers of the Bretton Woods System were the famous British economist John Maynard Keynes and American Chief International Economist of the U.S. Treasury Department Harry Dexter White. Keynes' hope was to establish a powerful global central bank to be called the Clearing Union and issue a new international reserve currency called the *bancor*. White's plan envisioned a more modest lending fund and a greater role for the U.S. dollar, rather than the creation of a new currency. In the end, the adopted plan took ideas from both, leaning more toward White's plan.

It wasn't until 1958 that the Bretton Woods System became fully functional. Once implemented, its provisions called for the U.S. dollar to be pegged to the value of gold. Moreover, all other currencies in the system were then pegged to the U.S. dollar's value. The exchange rate applied at the time set the price of gold at \$35 an ounce.

Benefits of Bretton Woods Currency Pegging

The Bretton Woods System included 44 countries. These countries were brought together to help regulate and promote international trade across borders. As with the benefits of all currency pegging regimes, currency pegs are expected to provide currency stabilization for the trade of goods and services as well as financing. All of the countries in the Bretton Woods System agreed to a fixed peg against the U.S. dollar with diversions of only 1% allowed. Countries were required to monitor and maintain their currency pegs which they achieved primarily by using their currency to buy or sell U.S. dollars as needed. The Bretton Woods System, therefore, minimized international currency exchange rate volatility which helped international trade relations. More stability in foreign currency exchange was also a factor in the successful support of loans and grants internationally from the World Bank.

4.2.10 The IMF

The Bretton Woods Agreement created two Bretton Woods Institutions, the IMF and the World Bank. The International Monetary Fund (IMF) is a key institution in the global finan-



- ◆ Under of last resort for countries

cial landscape, established in 1944 with the primary mission of promoting international monetary cooperation and exchange rate stability. It serves as a lender of last resort for countries facing balance of payments crises, offering financial assistance and policy advice to help stabilize economies and restore growth. The IMF's financial assistance programs typically come with conditions aimed at promoting fiscal discipline, structural reforms, and macroeconomic stability.

- ◆ Prevents and mitigate economic crises

Beyond its role as a provider of financial assistance, the IMF also serves as a forum for economic policy coordination and surveillance. Through its regular assessments of global and individual member country economies, the IMF monitors economic developments, identifies risks, and provides policy recommendations to promote macroeconomic stability and sustainable growth. This surveillance function helps prevent and mitigate economic crises by identifying vulnerabilities and providing early warning signals to policymakers.

The IMF provides technical assistance and capacity-building support to help member countries strengthen their economic institutions and policies. This includes assistance in areas such as fiscal management, monetary policy, financial regulation, and statistical capacity building. By enhancing countries' economic governance and policy frameworks, the IMF aims to promote more resilient and inclusive economic growth, ultimately contributing to poverty reduction and development around the world. The IMF plays a crucial role in promoting global economic stability, providing financial support, policy advice, and technical expertise to its member countries while fostering cooperation and coordination in the international monetary system.

The Bretton Woods System's Collapse

In 1971, concerned that the U.S. gold supply was no longer adequate to cover the number of dollars in circulation, President Richard M. Nixon devalued the U.S. dollar relative to gold. After a run on gold reserve, he declared a temporary suspension of the dollar's convertibility into gold. By 1973 the Bretton Woods System collapsed. Countries were then free to choose any exchange arrangement for their currency, except pegging its value to the price of gold. They could, for example, link its value to another country's currency, or a basket of currencies, or simply let it float freely and allow market forces to determine its value relative to other countries' currencies. The Bretton Woods Agreement remains a significant event in world financial history. The two Bretton Woods Institutions it created - International Monetary Fund and the World Bank- played an important part in helping to rebuild Europe in the aftermath of World War II. Subsequent-

ly, both institutions have continued to maintain their founding goals while also transitioning to serve global government interests in the modern-day.

4.2.11 The International Bank of Reconstruction and Development

The International Bank of Reconstruction and Development (IBRD) is a development bank administered by the World Bank. The IBRD offers financial products and policy advice to countries aiming to reduce poverty and promote sustainable development. The International Bank of Reconstruction and Development is a cooperative owned by 189 member countries. The International Bank of Reconstruction and Development (IBRD) is one of the two major institutions that make up the World Bank, the other being the International Development Association (IDA). The IDA is a financial institution dedicated to making developmental loans to the world's poorest countries. The IBRD was founded in 1944 with the goal of helping war-torn European countries rebuild their infrastructure and their economies. Following the recovery from World War II, the International Bank of Reconstruction and Development broadened its mandate to increasing global economic growth and eliminating poverty. Today, the IBRD focuses its services on middle-income countries or countries where the per capita income ranges from \$1,026 to \$12,375 per year. The IBRD adjusts these and other figures a bit yearly to account for inflation, economic changes within middle-income countries, and other factors.

Here are the key functions of the IBRD:

Financial Assistance

The primary function of the IBRD is to provide financial assistance to its member countries for development projects and programs. It offers a range of financial products, including loans, grants, and guarantees, to support investments in infrastructure, education, healthcare, agriculture, and other sectors critical for economic development.

Knowledge Sharing and Technical Assistance

The IBRD provides technical assistance, policy advice, and knowledge sharing to help member countries address development challenges and implement effective strategies for sustainable growth. This includes support for capacity building, institutional strengthening, and the dissemination of best practices and lessons learned from successful development experiences around the world.



Catalyst for Private Sector Investment

The IBRD mobilizes private sector investment by providing financing, risk mitigation instruments, and advisory services to support private sector projects in developing countries. By leveraging private sector resources, the IBRD aims to accelerate economic growth, create jobs, and promote entrepreneurship and innovation.

Policy Dialogue and Advocacy

The IBRD engages in policy dialogue with governments, civil society organizations, and other stakeholders to promote policy reforms and institutional changes that contribute to sustainable development. It advocates for inclusive growth, social inclusion, environmental sustainability, and good governance as key pillars of development effectiveness.

Global Public Goods

The IBRD supports global public goods initiatives that benefit all countries, such as climate change mitigation and adaptation, biodiversity conservation, and pandemic preparedness. It works to mobilize resources and coordinate efforts to address pressing global challenges that transcend national boundaries.

4.2.12 Asian Development Bank (ADB)

The Asian Development Bank (ADB) is a regional development institution established in 1966 to promote economic and social development in Asia and the Pacific. With a membership of 68 countries, including both developing and developed economies, the ADB works to alleviate poverty, improve living conditions, and foster sustainable growth across the region. Its operations cover a wide range of sectors, including infrastructure development, education, healthcare, agriculture, and environmental sustainability.

- ◆ Provides financial assistance

One of the primary functions of the ADB is to provide financial assistance to its member countries through loans, grants, and technical assistance. These financial resources support investment projects and programs that aim to address key development challenges, such as inadequate infrastructure, limited access to basic services, and economic disparities. By leveraging its financial strength and expertise, the ADB helps mobilize resources for development and catalyzes private sector participation in critical sectors.

In addition to financial assistance, the ADB plays a crucial role in promoting regional cooperation and integration. Through its operations and initiatives, the ADB fosters dialogue, knowledge sharing, and collaboration among its member countries to address common challenges and seize opportunities for mutual

- ◆ Promoting regional cooperation and integration

benefit. This includes support for regional infrastructure projects, trade facilitation, and policy coordination efforts aimed at promoting inclusive and sustainable development across the Asia-Pacific region. By promoting regional cooperation and integration, the ADB contributes to peace and stability, enhances economic resilience, and unlocks the region's full potential for growth and prosperity.

Summarised Overview

The World Trade Organisation (WTO) is the foundation of global trade regulation, embodying essential concepts and agreements that support the operation of international commerce. Its essential principles, which include nondiscrimination, reciprocity, and transparency, serve as the foundation for the multilateral trade system. These principles ensure that countries treat one another fairly in trade, creating an atmosphere that promotes economic growth and development. The WTO functions under a number of accords that govern various elements of trade, including the General Agreement on Tariffs and Trade (GATT), which governs trade in products, as well as agreements on services and intellectual property. These agreements establish standards and guidelines that member countries must follow, promoting a level playing field and decreasing the chance of trade conflicts. The WTO serves as a forum for negotiations aimed at further liberalising trade and reducing barriers to business. Compared to its predecessor, the General Agreement on Tariffs and Trade (GATT), the WTO has a broader scope and a more robust institutional architecture. While GATT was largely concerned with trade in products, the WTO also includes trade in services and intellectual property, reflecting the changing nature of global trade. The WTO also has a more robust dispute settlement structure, which allows trade problems to be resolved more quickly and efficiently. The WTO works closely with other trade organisations, such as the United Nations Conference on Trade and Development (UNCTAD), to promote development-oriented policies and projects. By collaborating, these organisations hope to ensure that the advantages of trade are shared equitably and that developing nations may fully participate in the global economy. The WTO operates within the larger framework of the Bretton Woods system, which was formed following World War II to foster international monetary cooperation and economic stability. Other institutions in this framework include the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD). While the IMF and IBRD focus on financial assistance and monetary stability, the WTO's principal goal is to regulate trade. In addition to global institutions like the IMF and IBRD, regional development banks like the Asian Development Bank (ADB) play an important role in promoting economic growth and stability. These organisations give financial assistance for infrastructure projects and other initiatives intended at boosting growth and alleviating poverty in developing countries. The WTO is an important participant in the global economic landscape, encouraging open, fair, and predictable trade relations among nations while working towards sustainable development and shared prosperity for all.



Self-Assessment Question

1. Can you explain the basic principles of the World Trade Organization (WTO) and how they contribute to fostering fair and predictable trade relations among member states?
2. What are some of the key agreements within the WTO framework, and how do they regulate trade in goods, services, and intellectual property?
3. How does the WTO differ from its predecessor, the General Agreement on Tariffs and Trade (GATT), in terms of scope, mandate, and institutional mechanisms?
4. Describe the functions and areas of operation of the WTO, including its role in dispute settlement and trade negotiations.
5. What was the global trade scenario like before the establishment of the WTO, and what factors led to the creation of this multilateral trade organization?
6. Explain the difference between the WTO and trade-related institutions such as the United Nations Conference on Trade and Development (UNCTAD) in terms of their objectives, scope, and functions.
7. How does the Bretton Woods system, which gave rise to institutions like the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD), influence the functioning of the WTO?
8. What are the primary functions of the IMF and IBRD, and how do they complement the role of the WTO in promoting global economic stability and development?
9. Describe the role of the Asian Development Bank (ADB) in the context of regional economic development and cooperation, and how it interacts with institutions like the WTO.
10. How does the WTO contribute to promoting development-oriented policies and initiatives, particularly in developing countries?
11. Can you discuss some of the challenges faced by the WTO in its efforts to regulate global trade, and how it addresses these challenges?
12. Explain the significance of the WTO's dispute settlement mechanism in resolving trade disputes among member states.
13. How does the WTO balance the interests of developed and developing countries in its decision-making processes and policy implementation?

Assignments

1. Write a comprehensive report on the basic principles of the World Trade Organization (WTO) and their implications for international trade.
2. Analyze and compare different WTO agreements, such as the General Agreement on Tariffs and Trade (GATT) and agreements on services and intellectual property,

- highlighting their key provisions and impact on global commerce.
3. Conduct a case study on the global trade scenario before the establishment of the WTO, examining the challenges and shortcomings of the pre-WTO era.
 4. Write an essay discussing the differences between GATT and the WTO in terms of their scope, mandate, and institutional mechanisms, and their significance for international trade regulation.
 5. Explore the role and functions of trade-related institutions like the United Nations Conference on Trade and Development (UNCTAD), analyzing their objectives, activities, and impact on global trade.
 6. Investigate the Bretton Woods system and its influence on the formation and development of international economic institutions, including the IMF, IBRD, and WTO.
 7. Analyze the functions and activities of the International Bank for Reconstruction and Development (IBRD), focusing on its efforts to support infrastructure development and poverty reduction in developing countries.
 8. Examine the role of the Asian Development Bank (ADB) in promoting regional economic development and cooperation in Asia, with a focus on its projects and initiatives.
 9. Prepare a case study on a recent trade dispute handled by the WTO, analyzing the legal and economic implications of the dispute and its resolution.
 10. Investigate the role of transparency and accountability in the functioning of the WTO, examining the organization's decision-making processes and policy implementation.

Suggested Reading

1. John Daniels, Lee Radebaugh, Daniel Sullivan International Business, Pearson Education, New York.
2. Anant Kumar Sundaram and J, Stewart Black, The International Business Environment: Text and Cases, PHI, New Delhi
3. Rakesh Mohan Joshi, International Business, Oxford University Press, New Delhi.

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1. Francis C., International Business: Text and Cases- PHI Learning Pvt. Ltd. New Delhi.
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9. Sumati, V.(2011). International Business. Ane Books Pvt Ltd, New Delhi..
10. V.K. Bhalla, International Business S. Chand & Company Pvt. Ltd. New Delhi.
11. Varma, S. (2012). International Business (1st Ed.). Pearson.

Space for Learner Engagement for Objective Questions

Learners are encouraged to develop objective questions based on the content in the paragraph as a sign of their comprehension of the content. The Learners may reflect on the recap bullets and relate their understanding with the narrative in order to frame objective questions from the given text. The University expects that 1 - 2 questions are developed for each paragraph. The space given below can be used for listing the questions.

SGOU



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MODEL QUESTION PAPER SETS

Set 1

MODEL QUESTION PAPER
SREENARAYANAGURU OPEN UNIVERSITY
Second Semester M. Com Degree Examination
(Core Course V)

M21CM06DC: GLOBAL BUSINESS OPERATIONS AND INSTITUTIONS

Maximum time: 3 hours

Maximum marks: 70

SECTION A

Answer any five of the following questions in one or two sentences each. Each question carries 2 marks.

1. Describe the term “global business” and differentiate it from a domestic business.
2. Briefly explain the concept of a strategic alliance.
3. What are the five main components of the international business environment?
4. Differentiate between PEST analysis and Porter’s Five Forces model.
5. List out some key characteristics of a multinational corporation?
6. Explain the term “offshoring” in the context of MNCs.
7. State the difference between a preferential trade area and a free trade area.
8. What is the ultimate goal of a political union?

(5x2=10)

SECTION B

Answer any six of the following questions in one page each. Each question carries 5 marks.

9. Explain the key features of a successful global business.
10. Elucidate the significance of global business and discuss the impact on both developed and developing economies
11. Discuss how cultural differences can affect consumer behaviour in international markets.
12. Explain the limitations of the Heckscher-Ohlin theory in explaining international trade patterns.
13. Discuss the advantages and disadvantages of MNCs for host countries.

14. What are the different types of FDI and critically examine how they can impact the host economy.
15. Examine the impact of regional trade agreements on FDI activities.
16. Illustrate the importance of the WTO's dispute settlement mechanism for international trade.
17. What are the key functions of the IBRD?
18. Explain the functions and areas of focus of the WTO with its predecessor, GATT.

(6x5=30)

SECTION C

Answer any two of the following questions in four pages each. Each question carries 15 marks.

19. Explain four different modes of entry: licensing, franchising, joint venture, and strategic alliance. Discuss the factors a company should consider when choosing an appropriate entry mode.
20. What are the components of the international business environment and how they affect a company's decision to enter a new foreign market?
21. Describe the characteristics and forms of MNCs.
22. Discuss the basic principles and key functions of the WTO. Critically evaluate the impact of the WTO on international trade and economic development.

(2x15=30)

Set 2

MODEL QUESTION PAPER
SREENARAYANAGURU OPEN UNIVERSITY
Second Semester M. Com Degree Examination
(Core Course V)
M21CM06DC: GLOBAL BUSINESS OPERATIONS AND INSTITUTIONS

Maximum time: 3 hours

Maximum marks: 70

SECTION A

Answer any five of the following questions in one or two sentences each. Each question carries 2 marks.

1. Explain two key features of global businesses.
2. Differentiate between licensing and franchising.
3. Explain the role of the legal environment in international business?
4. Define the term "national competitive advantage."
5. Differentiate between wholly-owned subsidiaries and joint ventures.
6. Describe the term "foreign direct investment."
7. What is the primary function of the Asian Development Bank?
8. Explain the term "trade creation" in the context of regional integration.

(5x2=10)

SECTION B

Answer any six of the following questions in one page each. Each question carries 5 marks.

9. What are the potential benefits and risks associated with mergers and acquisitions?
10. Discuss the significance of global business in today's economic landscape.
11. Explain the impact of the economic environment on international business decisions.
12. Explain the concept of intellectual property rights and its significance in international-business.
13. Differentiate between horizontal and vertical FDI.

14. Explain how MNCs can contribute to the economic development of developing nations.
15. Analyze the technological advancements on the strategies and operations of MNCs.
16. Discuss the difference between GATT and WTO?
17. What is the role of the International Monetary Fund (IMF) in the global economy?
18. Describe how globalization has influenced the roles and significance of the World Trade Organization.

(6x5=30)

SECTION C

Answer any two of the following questions in four pages each. Each question carries 15 marks.

19. Discuss how globalization has affected both developed and developing economies.
20. Evaluate the major theories of international trade. Discuss their strengths, weaknesses, and applicability in the modern international trading environment.
21. Describe the influence of multinational corporations on the economies, cultures, and environments of their host countries.
22. Write a note on various levels of economic integration.

(2x15=30)

സർവ്വകലാശാലാഗീതം

വിദ്യാൽ സ്വതന്ത്രരാകണം
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ശ്രദ്ധപ്രസാദമായ് വിളങ്ങണം
ഗുരുപ്രകാശമേ നയിക്കണേ

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സൂര്യവീഥിയിൽ തെളിക്കണം
സ്നേഹദീപ്തിയായ് വിളങ്ങണം
നീതിവൈജയന്തി പറണം

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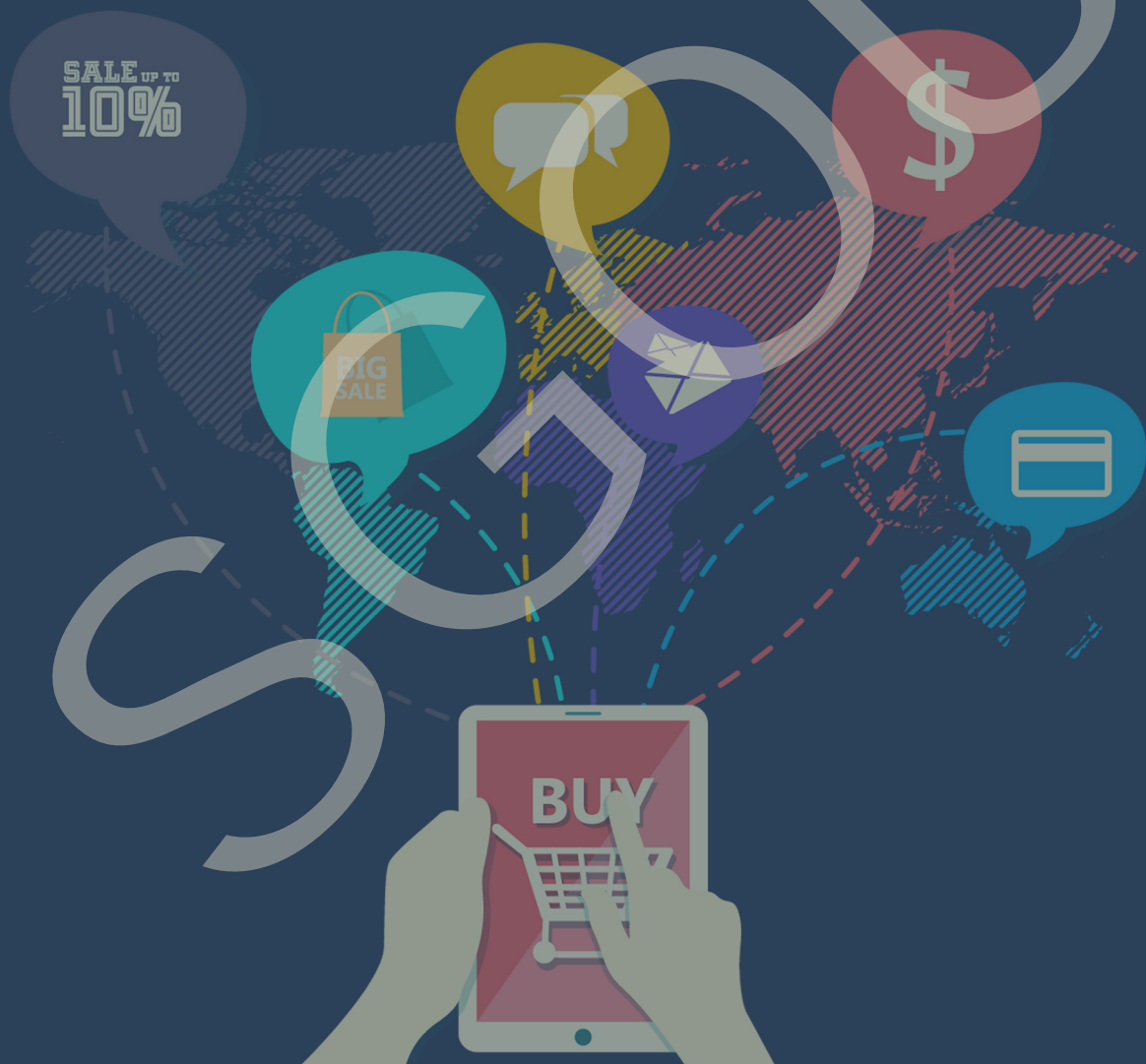
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