S.Y.M.M.S

SEMESTER - III - CORE

INTERNATIONAL BUSINESS

SUBJECT CODE: UMMSIII.1

Programme Co-ordinator : **Dr. Rajashri Pandit**
Assistant Professor (Economics)
IDOL, University of Mumbai,
Vidyanagari, Santacruz (E), Mumbai.

Course Co-ordinator and Editor : **Ms. Anitha Menon**
Assistant Professor (Management Studies)
IDOL, University of Mumbai,
Vidyanagari, Santacruz (E), Mumbai.

Course Writers : **Dr. Prashant Harishchandra Bhagat**
Assistant Professor
Chetana's Hazarimal Somani College of Commerce
and Economics, Bandra,
Mumbai – 400051.

: **Dr. Satinder Kaur Singh Gujral**
Assistant Professor
Reena Mehta College of Arts Science Commerce &
Management Studies, 150 Ft, Road opposite Maxus Mall,
Bhayander West, Thane 401101

Dr. Chandrashekhar V. Joshi
Visiting Faculty
Jamnalal Bajaj Institute of Management, Studies,164,
Backbay Reclamation, ,H.T. Parekh Marg, Churchgate,
Churchgate, Mumbai, Maharashtra 400020

December 2022, Print - 1 ISBN 978-93-95130-75-2

Published by : **Director,**
Institute of Distance and Open Learning,
University of Mumbai,
Vidyanagari,Mumbai - 400 098.

DTP composed and Printed by: Mumbai University Press

CONTENTS

M.M.S.
SEMESTER - III-CORE

INTERNATIONAL BUSINESS

SYLLABUS

Learning Objectives

1.	To develop a deep understanding of International Management
2.	To develop the analytical ability of the student to attain an insight into International Management contexts

Prerequisites if any	Business Management
Connection with subjects in thecurrent or future courses	International Marketing Strategic Management

Module

Sr. No.	Content	Activity	Learning Outcome
1.	Introduction ➢ Objective ➢ Scope ➢ Perlmutter's EPRG Model	**Lecture**	Understanding the scope of international business
2.	Country Analysis ➢ PESTEL analysis ➢ The Atlas of Economic Complexity ➢ Porters Diamond ➢ Country Risk analysis	**http://atlas.cid.harvard.edu Activity on PESTEL of emergingmarkets Lecture**	Evaluating country attractiveness,impact on business models
3.	Cross Cultural Management ➢ Hofstede's CulturalDimension ➢ CAGE Framework Pankaj Ghemawat ➢ Culture and Leader Effectiveness: The GLOBE Study	**Case/ lecture**	Understanding cultural differences and impact on business operations
4.	Mode of Entry ➢ Market/Country Entry Strategic Alliances/- JV /M&A	**Case / lecture**	Optimal way to enter a market

Sr. No.	Content	Activity	Learning Outcome
5.	Investment Decisions ➢ Drivers of FDI – Special emphasis on emerging markets ➢ Offshore Banking ➢ Forex Management – ADR-GDR's- EU bonds	**Case / lecture**	International finance decisionsand impact on operations
6.	WTO Regional TradeAgreements ➢ Building Blocks of WTO ➢ Major agreements of WTO	**Case / lecture**	Basics of WTO from theperspective of a business manager
7	Managing of Multinationals ➢ Organization Structure • Matrix • Geographic • Product ➢ International HRM • Expatriate Management • Staffing of Subsidiaries ➢ Integration ResponseModels • Types of subsidiaries • Control of subsidiaries ➢ Global manufacturing and supply chain • Optimizing of Supplychain • Offshoring V/SOutsourcing	**Cases /Lectures / Assignment**	Multinational and subsidiarydevelopment and management. Impact of I-R model onsubsidiary management.

1

INTRODUCTION TO INTERNATIONAL BUSINESS

Unit Structure

1.0 OBJECTIVES

- To study the scope and meaning of International Business
- To understand various Objectives of International Business
- To understand the Scope of International Business
- To understand the Perl mutter’s EPRG model

1.1 INTRODUCTION

This Unit introduces you to the study of international business and you’ll begin to learn what makes international business such an essential subject for students around the world. Because international business is a vital ingredient in strategic management and entrepreneurship, this book uses these complementary perspectives to help you understand international business. Managers, entrepreneurs, workers, for-profit and non-profit organizations, and governments all have a vested interest in understanding and shaping global business practices and trends.

One of the most dramatic and significant world trends in the past two decades has been the rapid, sustained growth of international business. International Business refers to the exchange of goods and services between two parties of different countries. International business includes any type of business activity that crosses national borders. Though a number of definitions in the business literature can be found but no simple or universally accepted definition exists for the term international business. At one end of the definitional spectrum, international business is defined as organization that buys and/or sells goods and services across two or more national boundaries, even if management is located in a single country. At the other end of the spectrum, international business is equated only with those big enterprises, which have operating units outside their own country. In the middle are institutional arrangements that provide for some managerial direction of economic activity taking place abroad but stop short of controlling ownership of the business carrying on the activity International Business is the process of focusing on the resources of the globe and objectives of the organization on the global business opportunities and threats in order to produce/buy/sell or exchange of goods and services worldwide.

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

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

International Trade to International Marketing: Originally, the producers used to export their products to the nearby countries and gradually extended the exports to far-off countries. Gradually, the companies extended the operations beyond trade.

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

History of international business starts with the evolution of human civilization. The integration and growth of economies and societies was the main reason for the first phase of international business and globalization.

Timeline

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

- 1930's: Declined Trade Ratio, GDP
- After 1930's: World Nations felt the need for International Cooperation in global trade and balance of payments affairs, Establishment of IMF and IBRD (World Bank), IMF: International Monetary Fund, IBRD: International Bank for Reconstruction and Development
- 1947: 23 countries conducted negotiations in order to prevent the protectionist policies and to revive the economies from recession aiming at establishment of World Trade organization
- 1947: Establishment of GATT (General Agreement on Trade and Tariffs)
- 1980s: efforts to convert GATT into WTO
- 1st Jan 1995: GATT was replaced by WTO (World Trade Organization),Trade Liberalization
- 1990 – 2000: The Term IB (International Business) has emerged from the term International Marketing.

  There are two Phases of the evolution of the term International Business

  1. International Trade to International Marketing
  2. International Marketing to International Business
- After 1990: Rapid Internationalization ad globalization

  Today: Interpreting the PESTIN factors of International Trade environment more clearly.

Definitions:

"International business consists of transactions that are devised and carried out across national borders to satisfy the objectives of the individuals, companies and organisations. These transactions take on various forms which are often interrelated." – Michael R. Czinkota

"International business involves commercial activities that cross national frontiers" – Roger Bennett

1.2 OBJECTIVES

1. **To overcome the limitations of domestic market:** Some demographic trends such as contraction in birth rate decline in domestic demand, fully tapped market opportunities etc. have adverse effect on some business in domestic market. When domestic market is small or saturated then International Business is the alternative for the business growth. Also, Recession in the home market drives the companies to explore into foreign markets.

2. **Explore markets with better profitability:** This is an obvious reason for a lot of local companies to enter into an international markets. An international market could have a higher purchasing

power and therefore, the same products can earn better profits in international market. This is obviously minus the initial go-to-market cost of breaking into that international market.

3. **Achieve economies of scale with a larger customer base:** Some goods and commodities provide the company with great economies of scale opportunities. The effects of economies of scale can be magnified when a larger base of customers come into the business. This is pretty relevant to tech-based companies who can be easily classified as 'born-global companies. This companies can offer their technology products to a new customer, anywhere in the world at no additional costs.

4. **Reduce over dependence on any one market:** Each business should be diversified across products and also across the market segments that it targets. This protects the business from uncertainties. This is another reason why a company should expand internationally. Usually, it would stabilize the product portfolio as well as customer portfolio to make the business robust against seasonality and the uncertainties.

5. **Attract foreign demand**: Some companies are unable to increase their market share due to fierce competition within the industry. Alternatively, changing consumer tastes could reduce demand for the company’s products. Both of these conditions allow an entity to consider foreign markets where potential demand may exist. Therefore international business is the philosophy for focusing efforts for attracting foreign demands for future growth in the international market.

6. **Global Customer Service:** There could be tech companies who already serve customers around the world despite being cantered an only their home country. When the company has enough number of big ticket customers in some part of the world, they can think about setting up an office there and further expand their customer base. This is done better when the company serves the international market with personalized and culturally

7. **Utilize technology:** Many companies are establishing new businesses in developing countries, where the technology level is relatively low. Some companies have established new communication systems in developing countries. Other companies that create power generation, highway systems, and other forms of infrastructure do extensive business in these countries. Motor Company and General Motors are seeking to take advantage of the technology by establishing factories in developing countries in Asia, Latin America, and Eastern Europe. So, using international technology is also one of the objective of international business.

8. **Use of economic resources:** Labour and land costs vary widely from country to country. Companies often try to establish production in places where land and labor are cheap. The cost is much higher in

developed countries than in other countries. Many companies have subsidiaries in countries with low labor costs. E.g. many companies have set up production plants in Singapore and Taiwan to take advantage of labor cost savings. Many companies have also set up factories in Hungary, Poland, and other Eastern European countries with low labor costs.

9. International diversification:

The company can mitigate this risk by selling its products in several countries through international diversification. Many companies doing international business are less affected by economic conditions, as economic conditions can vary from country to country. If a company sells its products in multiple countries, overall performance may be more stable, so the business is not affected by the economic situation in one country alone. For example, if the economy is weak, demand for products may decrease, while economic growth in other parts of the world may increase for the overall demand of the products.

10. To earn Foreign exchange:

The international business exports its goods and services to all over the world. It helps a country to earn valuable foreign exchange which can be used to pay for imports. Foreign exchange helps to make the business more profitable and to strengthen the economy of the country. It increases the investment in the business which is important for the economic stability of the country.

11. To acquire new knowledge and technology:

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

1.3 SCOPE

1. Foreign Investments:

Foreign investment is an important part of international business. Foreign investment contain investments of funds from the abroad in exchange for financial return. Foreign investment is done through investment in foreign countries through international business. Foreign investments are two types which are direct investment and portfolio investment.

2. Exports and Imports of Merchandise:

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

3. **Service Exports and Imports:**

Services exports and imports consist of the 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, constructing, training, educational, financial services etc. Tourism and travel are major components of world trade in services.

4. **Licensing and Franchising:**

Franchising means giving permission to the new party of the foreign country in order to produce and sell goods under your trademarks, patents or copyrights in exchange of some fee is also the way to enter into the international business. Licensing system refers to the companies like Pepsi and Coca-Cola which are produced and sold by local bottlers in foreign countries.

5. **Growth Opportunities**:

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

6. **Global services:**

The international firms also trade in services like banking, insurance, communications, consulting, travel etc. earn in the forms of fees and royalties. The fees are earned through short term and long term contractual agreements such as consultancy or management contracts or turnkey projects. Royalties are received from the use of one company's name, trademark, patent or process by someone else. Similarly, firm can use royalties from abroad by licensing the use of its name, trademark, patent, technology information, Franchise in overseas market.

1.4 PERLMUTTER'S EPRG MODEL

Introduction:

EPRG stand for Ethnocentric, Polycentric, Regiocentric, and Geocentric. It is a framework created by Howard V Perlmuter and Wind and Douglas in 1969. It is designed to be used in an internationalization process of businesses and mainly addresses how companies view international management orientations. Different attitudes towards company's involvement in international marketing process are called international marketing orientations. This framework addresses the way strategic decisions are made and how the relationship between headquarters and its subsidiaries is shaped. The EPRG framework addresses the ways strategic decisions are made in the company and what is the nature of relationship between the companies' headquarters and its subsidiaries outside. It consists of 4 stages and the framework states that companies operate in International markets

The EPRG framework is a useful tool for understanding an organisation's attitude towards international marketing. The framework looks at how an organisations orientation towards internationalisation can influence strategy.

Stages:

Perlmutter's EPRG framework consists of four stages in the international operations evolution. These stages are discussed below.

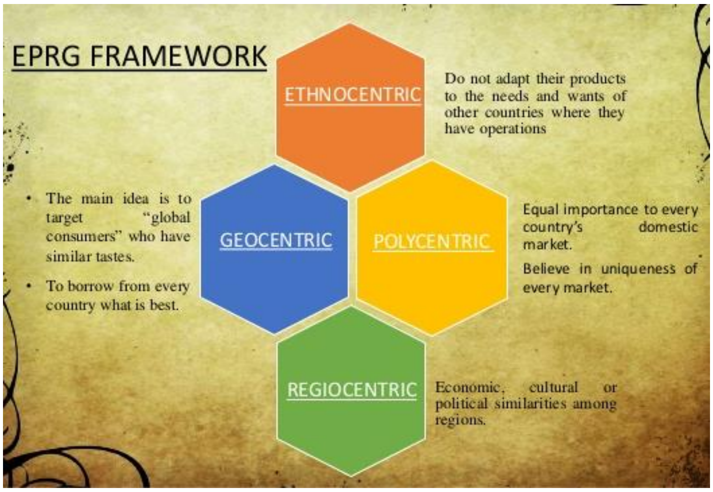


Fig 1: EPRG Framework

1. Ethnocentric Orientation:

The practices and policies of headquarters and of the operating company in the home country become the default standard to which all subsidiaries need to comply. Such companies do not adapt their products to the needs and wants of other countries where they have operations. There are no changes in product specification, price and promotion measures between native market and overseas markets.

The general attitude of a company's senior management team is that nationals from the company's native country are more capable to drive international activities forward as compared to non-native employees working at its subsidiaries. The exercises, activities and policies of the functioning company in the native country becomes the default standard to which all subsidiaries need to abide by.

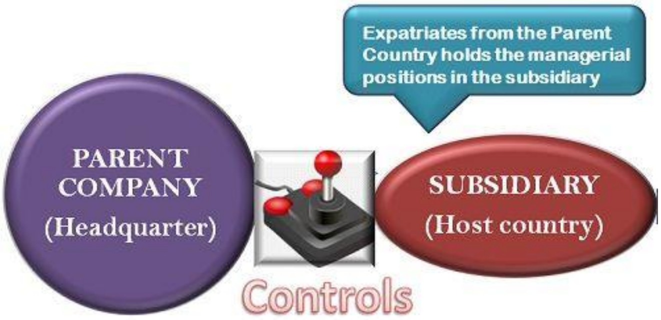


Fig No. 2

The benefit of this mind set is that it overcomes the shortage of qualified managers in the anchoring nations by migrating them from home countries. This develops an affiliated corporate culture and aids transfer core competences more easily. The major drawback of this mind set is that it results in cultural short-sightedness and does not promote the best and brightest in a firm.

The advantages of ethnocentric approach can be as follows:

1. Better coordination between the host and the parent company.

2. The culture of the parent company can be easily transferred to the subsidiary company, thereby infusing beliefs and practices into the foreign country this also help in controlling the subsidiary effectively.

3. The parent company can have a close watch on the operations of the subsidiary.

2. Regiocentric Orientation

In this approach a company finds economic, cultural or political similarities among regions in order to satisfy the similar needs of potential consumers. For example, countries like Pakistan, India and Bangladesh are very similar. They possess a strong regional identity.

Fig No. 3

It is an approach adopted by a firm wherein it adopts a marketing strategy across a group of countries, which have been grouped on the basis of their market characteristics; i.e., the market characteristics of these countries would be more or less similar. The company which follows this approach of framework studies the similarities in markets to design strategies. The management of the company records the economic, social, cultural, and political similarities between the native areas of the overseas region to sell its products and services to potential customers. It is worth noting that the cultural and regional identity of India, Pakistan, and Bangladesh is quite similar whereas Norway and Spain that both falls in Europe are very different in terms of culture, climate, and transport amongst other aspects.

Some of the advantages of regiocentric approach are as follows:

1. It helps cultural fit. When organizations hire the managers from the same region as that of the host country may not encounter any problem with respect to the culture and the language followed there. It costs less in hiring the natives of the host country.
2. The managers work well in all the neighbouring countries within the geographic region of the business.
3. The nationals of host country can influence the decision of managers at headquarters with respect to the entire region.

3. Geocentric Orientation

Geocentric approach encourages global marketing. This does not equate superiority with nationality. Irrespective of the nationality, the company tries to seek the best men and the problems are solved globally within the legal and political limits. Thus, ensuring efficient use of human resources by building strong culture and informal management channels.

The main disadvantages are that national immigration policies may put limits to its implementation and it ends up expensive compared to polycentrism. Finally, it tries to balance both global integration and local responsiveness.

Fig No. 4

It is practiced when an organisation does not organise its strategies based on country or regions. Geocentric firms adopt an approach whereby they have a global mind-set. They view the whole world as their market and seek to identify global needs and wants and create products and services. The companies following the geocentric approach of the EPRG Framework are truly the global players. They think global and act global. Their HR policies for staffing and job position approach to staffing assigns job positions to any person best suited for the position, regardless of the employee's background, culture or country of origin. These organizations understand costing in hiring in terms of immigration policies; costs of worker relocation and diversity management create pressure on HR management.

Advantages of geocentric orientation are as follows:

1. MNC's can develop a pool of senior executives with international experiences and contacts across the borders in the world. The expertise of each manager can be used for the accomplishment organization's objective as a whole.
2. Reduction in resentment, i.e. the sense of unfair treatment reduces.
3. Shared learning, the employees, will learn from each other's experiences.

4. Polycentric Orientation

In this approach, a company gives equal importance to every country's domestic market. Every participating country is treated solely and individual strategies are carried out. This approach is especially suitable for countries with certain financial, political and cultural constraints.

This perception mitigates the chance of cultural myopia and is often less expensive to execute when compared to ethnocentricity. This is because it does not need to send skilled managers out to maintain centralized policies. The major disadvantage of this nature is it can restrict career mobility for both local as well as foreign nationals, neglect headquarters of foreign subsidiaries and it can also bring down the chances of achieving synergy.

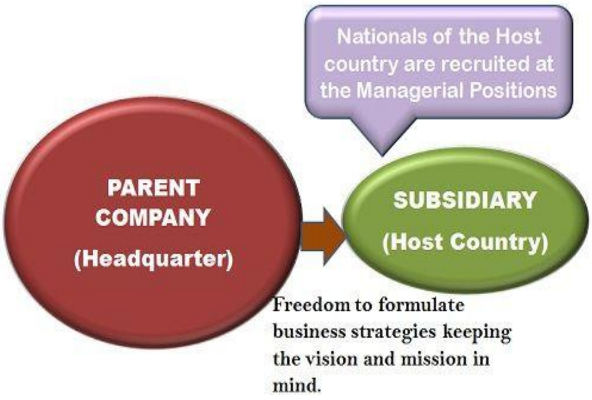


Fig No. 5

Polycentric approach of business can be defined as host country orientation. Here the host country's customs, behaviour, culture, language is considered while doing business. Under a polycentric perspective, a company's management team believes that it is better to adopt host country's culture to befriend the customers, suppliers and government. In Polycentric orientation organizations see host country's unique and exclusive conduct because businesses are best run locally as per local culture. This approach lays a strong groundwork because every subsidiary develops its unique marketing and business strategies for success and the country's domestic market is given equal importance. This approach is best suited for the developing countries in which certain constraints on the front of finance, political, and cultural front are experienced.

The advantages of polycentric approach are as follows:

1. The difficulty in the adjustment of expatriates from the parent country gets removed.
2. The hiring of locals or the nationals of the host country is comparatively less expensive. The morale of the local staff increases.
3. Better productivity due to better knowledge about the host market; the career opportunities for the nationals of the host country increases.
4. Better government support.

1.5 SUMMARY

This unit attempts to give an overview of the functions in as simple manner as possible.

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

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

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

4. ERPG Model is designed to be used in an internationalization process of businesses and mainly addresses how companies view international management orientations.

1.6 QUESTIONS

1. Explain the meaning and Objectives of International Business.

2. What are the various Scope of International Business?

3. Explain the ERPG model in International Business.

1.7 REFRENCES

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

2. Cherunillam Francis, International Business, Text and Cases, 3rd Edition, Prentice-Hall of India Private Limited.

3. Francis Cherunillam, Global Business Environment, Prentice-Hall of India Private Limited.

❄❄❄❄❄❄❄

2

INTERNATIONAL BUSINESS-ANALYSIS & MODELS

Unit Structure

2.0 OBJECTIVES

1. To study the PESTEL Analysis

2. To understand The Atlas of Economic Complexity.

3. To understand the Porters Diamond

4. To understand the Country Risk Analysis

2.1 PESTEL ANALYSIS

2.1.1 Meaning

The PESTEL analysis can be instrumental in evaluating the characteristics and changes in the environment that can affect a company's success, from which the right decisions can be made at the right time. A PESTEL analysis is an acronym for a tool used to identify the macro (external) forces facing an organisation. The letters stand for Political, Economic, Social, Technological, Environmental and Legal. In this blog, we will look at what a PESTEL analysis is used for as well as the advantages and disadvantages of using it in a business setting.

A PESTEL analysis is a tool that allows organizations to discover and evaluate the factors that may affect the business in the present and in the future. With the results offered by the PEST analysis, it is possible to have a favourable view when carrying out market research, creating marketing strategies, developing products, and making better decisions for the organization.

2.1.2 Factors of PESTEL Analysis

Political Factors: These determine the extent to which government and government policy may impact on an organisation or a specific industry. This would include political policy and stability as well as trade, fiscal and taxation policies too. These factors determine the extent to which a government may influence the economy or a certain industry. For example, a government may impose a new tax or duty due to which entire revenue generating structures of organizations might change. Political factors include tax policies, Fiscal policy, trade tariffs, etc. that a government may levy around the fiscal year and it may affect the business environment (economic environment) to a great extent.

Economic Factor: An economic factor has a direct impact on the economy and its performance, which in turn directly impacts on the organisation and its profitability. Factors include interest rates, employment or unemployment rates, raw material costs and foreign exchange rates. These factors are determinants of an economy's performance that directly impacts a company and have resonating long term effects. For example, a rise in the inflation rate of any economy would affect the way companies' price their products and services. Adding to that, it would affect the purchasing power of a consumer and change demand/supply models for that economy. Economic factors include inflation rate, interest rates, foreign exchange rates, economic growth patterns, etc. It also accounts for the FDI (foreign direct investment) depending on certain specific industries who're undergoing this analysis.

Social Factor: The focus here is on the social environment and identifying emerging trends. This helps a marketer to further understand consumer needs and wants in a social setting. Factors include changing family demographics, education levels, cultural trends, attitude changes and changes in lifestyles. These factors scrutinize the social environment of the market and gauge determinants like cultural trends, demographics, population analytics, etc. An example of this can be buying trends for Western countries like the US where there is high demand during the Holiday season.

Technological Factor: These factors pertain to innovations in technology that may affect the operations of the industry and the market favourably or unfavourably. This refers to automation, research and development, and the amount of technological awareness that a market possesses. Technological factors consider the rate of technological innovation and development that could affect a market or industry. Factors could include changes in digital or mobile technology, automation, research and development. There is often a tendency to focus on developments only in digital technology, but consideration must also be given to new methods of distribution, manufacturing and logistics.

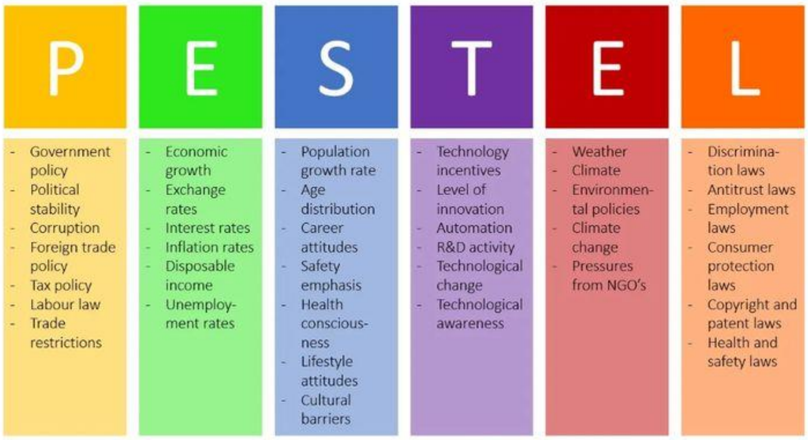


Fig 2.1: PESTEL Analysis

Legal Factor: An organisation must understand what is legal and allowed within the territories they operate in. They also must be aware of any change in legislation and the impact this may have on business operations. Factors include employment legislation, consumer law, health and safety, international as well as trade regulation and restrictions. .There are certain laws that affect the business environment in a certain country while there are certain policies that companies maintain for themselves. Legal analysis takes into account both of these angles and then charts out the strategies in light of these legislations. For example, consumer laws, safety standards, labor laws, etc.

Environmental Factor: Environmental factors are those that are influenced of the surrounding environment and the impact of ecological aspects. With the rise in importance of CSR (Corporate Sustainability Responsibility) and sustainability, this element is becoming more central to how organisations need to conduct their business. Factors include climate, recycling procedures, carbon footprint, waste disposal and sustainability. This aspect of the PESTLE is crucial for certain industries particularly for example tourism, farming, agriculture, etc. Factors of a business environmental analysis include but are not limited to climate, weather, geographical location, global changes in climate, environmental offsets, etc.

2.1.3 Advantages of a PESTEL Analysis

i. It can provide an advance warning of potential threats and opportunities
ii. It encourages businesses to consider the external environment in which they operate
iii. The analysis can help organisations understand external trends

2.1.4 Disadvantages of a PESTEL Analysis

i. Many researchers argued that simplicity of the model that it is a simple list which is not sufficient and comprehensive
ii. The most significant disadvantage of the model is it is only based on an assessment of the external environment.

2.1.5 Conclusion on PESTEL analysis

PESTEL analysis is ideal for all organizations that want to understand and measure current and future markets. It is essential to mention that an organization's approach to each factor in the PESTEL analysis depends on the sector in which they focus.

With a PESTEL analysis, companies can visualize the risks and make the most of the business opportunities in the market. If you want to know the best methodologies and tools for decision-making, we invite you to learn everything you need to identify the best opportunities for business success.

2.2 THE ATLAS OF ECONOMIC COMPLEXITIES

2.2.1 Meaning

Hidalgo and Hausmann propose the concept of ECI not only as a descriptive measure, but also as a predictive tool for economic growth and income inequality. AEC is a Harvard Growth Lab's research and data visualization tool used to understand the economic dynamics and new growth opportunities for every country worldwide. It is a measure of the knowledge in a society as expressed in the products it makes. The economic complexity of a country is calculated based on the diversity of exports. The Atlas of Economic Complexity attempts to measure the amount of productive knowledge that each country holds. The Economic Complexity Index (ECI) and the Product Complexity Index (PCI) are, respectively, measures of the relative knowledge intensity of an economy or a product. Measure of productive knowledge can account for the enormous income differences between the nations of the world and has the capacity to predict the rate at which countries will grow. In fact, it is much more predictive than other well-known development indicators, such as those that attempt to measure competitiveness, governance and education.

A central contribution of this Atlas is the creation of a map that captures the similarity of products in terms of their knowledge requirements. This map provides paths through which productive knowledge is more easily accumulated. We call this map, or network, the product space, and use it to locate each country, illustrating their current productive capabilities and the products that lie nearby.

The overall ranking of Best Countries measure global performance on a variety of metrics. Switzerland is the best country in the world for 2022. India maintained 43rd rank on an annual World Competitiveness Index compiled by the Institute for Management Development (IMD).

Ultimately, the complexity of an economy is related to the multiplicity of useful knowledge embedded in it. For a complex society to exist, and to sustain itself, people who know about design, marketing, finance, technology, human resource management, operations and trade law must be able to interact and combine their knowledge to make products. These same products cannot be made in societies that are missing parts of this capability set. Economic complexity, therefore, is expressed in the composition of a country's productive output and reflects the structures that emerge to hold and combine knowledge. Increased economic complexity is necessary for a society to be able to hold and use a larger amount of productive knowledge, and we can measure it from the mix of products that countries are able to make.

2.2.2 Importance

As economic complexity reflects the amount of knowledge that is embedded in the productive structure of an economy. Seen this way, it is no coincidence that there is a strong correlation between our measures of economic complexity and the income per capita that countries are able to generate.

Economic complexity, therefore, is related to a country's level of prosperity. As such, it is just a correlation of things we care about. The relationship between income and complexity, however, goes deeper than this. Countries whose a economic complexity is greater than what we would expect, given their level of income, tend to grow faster than those that are "too rich" for their current level of economic complexity.

The ability of the ECI to predict future economic growth suggests that countries tend to move towards an income level that is compatible with their overall level of embedded knowhow.

In short, economic complexity matters because it helps explain differences in the level of income of countries and more important, because it predicts future economic growth. Economic complexity might not be simple to accomplish, but the countries that do achieve it, tend to reap important rewards.

The Economic Complexity Index is not easy to manipulate through a narrow set of decisions. Ultimately, countries improve on the index by being able to increase the number of different activities they can successfully engage in and by moving towards activities that are more complex. The policy message for most countries is clear: create an environment where a greater diversity of productive activities can thrive and, in particular, activities that are relatively more complex. Countries are more likely to succeed in this agenda if they focus on products that are close to their current set of productive capabilities, as this would facilitate the identification and provision of the missing capabilities.

2.3 PORTER'S DIAMOND MODEL

2.3.1 Introduction

In 1990, Michael Porter, considered to be the founder of the modern strategy field put a modern twist on Adam Smith's ideas by publishing a book entitled "The Competitive Advantage of Nations". In this book, based on a study of ten nations, Porter argued that the productivity of firms and workers collectively was key to national wealth. While this argument was not new, as Smith had discussed this in the 18th century, Porter went further by detailing how the national and regional environments can support, or impair, that productivity. He created a diamond-shaped framework to explain the international competitiveness of different industries.

Michael Porter's Diamond Model (also known as the Theory of National Competitive Advantage of Industries) is a diamond-shaped framework that focuses on explaining why certain industries within a particular nation are competitive internationally, whereas others might not. And why is it that certain companies in certain countries are capable of consistent innovation, whereas others might not? Porter argues that any company's ability to compete in the international arena is based mainly on an interrelated set of location advantages that certain industries in different nations possess, namely: Firm Strategy, Structure and Rivalry; Factor Conditions; Demand Conditions; and Related and Supporting Industries. If these conditions are favourable, it forces domestic companies to continuously innovate and upgrade. The competitiveness that will result from this, is helpful and even necessary when going internationally and battling the world's largest competitors. This article will explain the four main components and include two components that are often included in this model: the role of the Government and Chance. Together they form the national environment in which companies are born and learn how to compete.

2.3.2 Components of Porter's Diamond Model

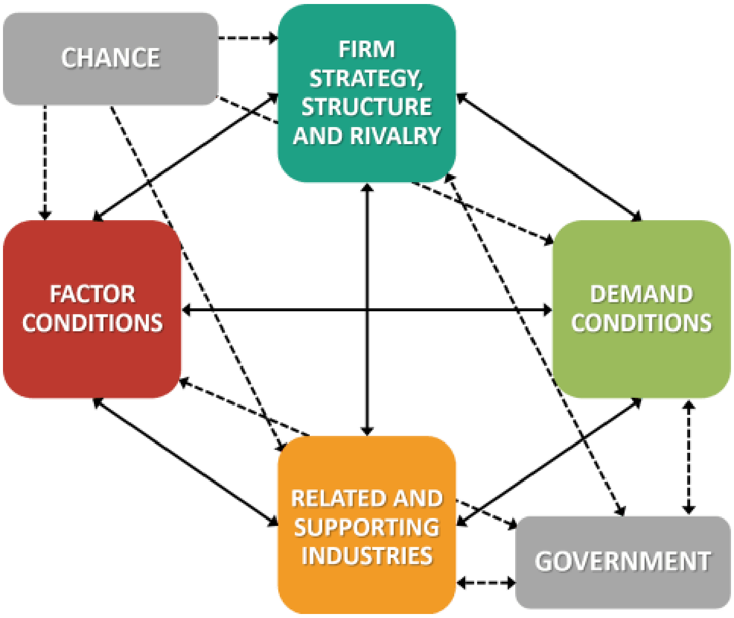


Figure 2.2 : Porter's Diamond Model of National Competitive Advantage

1. **Firm Strategy, Structure and Rivalry:**

The national context in which companies operate largely determines how companies are created, organized and managed: it affects their strategy and how they structure themselves. Moreover, domestic rivalry is instrumental to international competitiveness, since it forces companies to develop unique and sustainable strengths and capabilities. The more intense domestic rivalry is, the more companies are being pushed to innovate and improve in order to maintain their competitive advantage. In the end, this will only help companies when entering the international arena. A good example for this is the Japanese automobile industry with intense rivalry between players such as Nissan, Honda, Toyota, Suzuki, Mitsubishi and Subaru. Because of their own fierce domestic competition, they have become able to more easily compete in foreign markets as well.

2. Factor Conditions:

Factor conditions in a certain country refer to the natural, capital and human resources available. Some countries are for example very rich in natural resources such as oil for example (Saudi Arabia). This explains why Saudi Arabia is one of the largest exporters of oil worldwide. With human resources, we mean created factor conditions such as a skilled labor force, good infrastructure and a scientific knowledge base. Porter argues that especially these 'created' factor conditions are important opposed to 'natural' factor conditions that are already present. It is important that these created factor conditions are continuously upgraded through the development of skills and the creation of new knowledge. Competitive advantage results from the presence of world-class institutions that first create specialized factors and then continually work to upgrade them. Nations thus succeed in industries where they are particularly good at factor creation.

3. Demand Conditions:

The home demand largely affects how favourable industries within a certain nation are. A larger market means more challenges, but also creates opportunities to grow and become better as a company. The presence of sophisticated demand conditions from local customers also pushes companies to grow, innovate and improve quality. Striving to satisfy a demanding domestic market propels companies to scale new heights and possibly gain early insights into the future needs of customers across borders. Nations thus gain competitive advantage in industries where the local customers give companies a clearer or earlier picture of emerging buyer needs, and where demanding customer's pressure companies to innovate faster and achieve more sustainable competitive advantages than their foreign rivals.

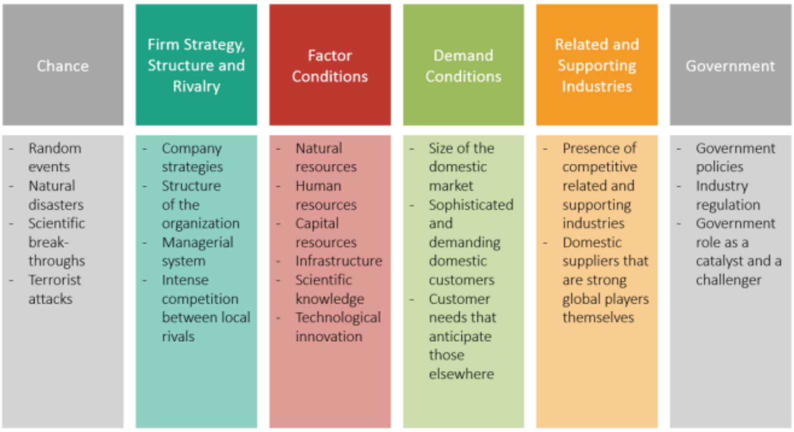


Fig 2.3: Porter's Diamond Model factors

4. Related and Supporting Industries:

The presence of related and supporting industries provides the foundation on which the focal industry can excel. As we have seen with the Value Net, companies are often dependent on alliances and partnerships with other companies in order to create additional value for customers and become more competitive. Especially suppliers are crucial to enhancing innovation through more efficient and higher-quality inputs, timely feedback and short lines of communication. A nation's companies benefit most when these suppliers themselves are, in fact, global competitors. It can often take years (or even decades) of hard work and investments to create strong related and supporting industries that assist domestic companies to become globally competitive. However, once these factors are in place, the entire region or nation can often benefit from its presence. We can for example see this in Silicon Valley, where all kinds of tech-giants and tech-start-ups are clustered in order to share ideas and stimulate innovation.

5. Government:

The role of the government in Porter’s Diamond Model is described as both ‘a catalyst and challenger‘. Porter doesn’t believe in a free market where the government leaves everything in the economy up to ‘the invisible hand’. However, Porter doesn’t see the government as an essential helper and supporter of industries either. Governments cannot create competitive industries; only companies can do that. Rather, governments should encourage and push companies to raise their aspirations and move to even higher levels of competitiveness. This can be done by stimulating early demand for advanced products (demand factors); focusing on specialized factor creations such as infrastructure, the education system and the health sector (factor conditions); promoting domestic rivalry by enforcing anti-trust laws; and encouraging change. The government can thus assist the development of the four aforementioned factors in the way that should benefit the industries in a certain country.

6. Chance:

Even though Porter originally didn’t write anything about chance or luck in his papers, the role of chance is often included in the Diamond Model as the likelihood that external events such as war and natural disasters can negatively affect or benefit a country or industry. However, it also includes random events such as where and when fundamental scientific breakthroughs occur. These events are beyond the control of the government or individual companies. For instance, the heightened border security, resulting from the September 11 terrorist attacks on the US undermined import traffic volumes from Mexico, which has had a large impact on Mexican exporters. The discontinuities created by chance may lead to advantages for some and disadvantages for other companies. Some firms may gain competitive positions, while others may lose. While these factors cannot be changed, they should at least be monitored so you can make decisions as necessary to adapt to changing market conditions.

2.3.3 Application

Porter's Diamond Model is used to understand the competitive advantages and disadvantages of a country or organization in any field. It can be used to understand the suitable measures that can be taken by the country or organization to improve its performance.

2.3.4 Conclusion

The diamond is a model for identifying multiple dimensions of microeconomic competitiveness in nations, states, or other locations, and understanding how they interact. By identifying and improving elements in the diamond that are barriers to productivity, locations can improve competitiveness. Porter's Diamond Model is used to understand the competitive advantages and disadvantages of a country or organization in any field. It can be used to understand the suitable measures that can be taken by the country or organization to improve its performance.

2.4 COUNTRY RISK ANALYSIS

2.4.1 Meaning

Country risk is described as the economic, political and business risks that are distinctive to a specific country, and that might result in unforeseen investment losses. Mainly, Country risk refers to the risk of investing or lending in a country, arising from possible modifications in the business environment that may unfavourably affect operating profits or the value of assets in the country. Country Risk Analysis is the evaluation of possible risks and rewards from business experiences in a country. It is used to survey countries where the firm is engaged in international business, and avoids countries with excessive risk. With globalization, country risk analysis has become essential for the international creditors and investors.

Country risk analysis also identifies imbalances that increase the risks in a cross-border investments. Country risk analysis represents the potentially adverse impact of a country's environment on the multinational corporation's cash flows and is the probability of loss due to exposure to the political, economic, and social upheavals in a foreign country. All business dealings involve risks.

An increasing number of companies involving in external trade indicate huge business opportunities and promising markets. When business transactions occur across international borders, they bring additional risks compared to those in domestic transactions. These additional risks are called country risks which include risks arising from national differences in socio-political institutions, economic structures, policies, currencies, and geography. The country risk analysis monitors the potential for these risks to decrease the expected return of a cross-border investment. For example, a multinational enterprise (MNE) that sets up a plant in a foreign country faces different risks compared to bank lending to a foreign government. The MNE must consider the risks from a broader spectrum of country characteristics. Some categories relevant to a plant investment contain a much higher degree of risk because the MNE remains exposed to risk for a longer period of time.

2.4.2 Importance

Globalization and increasing financial unification has led to a rapid growth of international lending, foreign direct and institutional investment. With this, economies across the globe are increasingly becoming interdependent and developments in one part of the world affect returns in another. Given this, country risk analysis provides insights into that part of the risk of an investment specific to a certain country. "Country Risk", in general refers to the risk associated with those factors that determine or affect the ability and willingness of a sovereign state or borrower from a particular country to fulfil their obligations towards one or more foreign lenders and / or investors; this is the approach and the definition used by Bates and Saini (1984) as well as by Abassi and Taffler (1982).

A country risk assessment can help a business identify and evaluate country-specific risks. In doing so, businesses can determine how much those risks might impact their business and what steps they can take to manage or mitigate those risks. The importance of this type of country risk analysis cannot be overstated.

Country risk signifies the potentially adverse impact of a country's environment on the MNC's cash flows. Country risk covers factors to influence the default risk of the country resulting from economic deterioration, political events, currency depreciation and so on.

2.4.3 Types of Country Risk Analysis

1. **Economic risk** — This type of risk is the important change in the economic structure that produces a change in the expected return of an investment. Risk arises from the negative changes in fundamental economic policy goals (fiscal, monetary, international, or wealth distribution or creation).

2. **Transfer risk** — Transfer risk arises from a decision by a foreign government to restrict capital movements. It is neighbour as a function of a country's ability to earn foreign currency. Therefore, it implies that effort in earning foreign currency increases the possibility of capital controls.

3. **Exchange risk** — This risk occurs due to an neighbourhood movement in the exchange rate. Exchange risk can be defined as a form of risk that arises from the change in price of one currency against another. Whenever investors or companies have assets or business operations across national borders, they face currency risk if their positions are not hedged.

4. **Location risk** — This type of risk is also referred to as neighbourhood risk. It includes effects caused by problems in a region or in countries with similar characteristics. Location risk includes effects caused by troubles in a region, in trading partner of a country, or in countries with similar perceived characteristics.

5. **Sovereign risk** — This risk is based on a government's inability to meet its loan obligations. Sovereign risk is closely linked to transfer risk in which a government may run out of foreign exchange due to adverse developments in its balance of payments. It also relates to political risk in which a government may decide not to honour its commitments for political reasons.

6. **Political risk** — This is the risk of loss that is caused due to change in the political structure or in the politics of country where the

investment is made. For example, tax laws, expropriation of assets, tariffs, or restriction in repatriation of profits, war, corruption and bureaucracy also contribute to the element of political risk.

2.4.4 Techniques of Assessing Country Risk

Country risk, which embodies uncertainty of payback from international business, is perceived and measured linguistically as well as numerically (Terpstra and Yu 1988). There are various techniques of country risk analysis (Madura, 2008)

i. A checklist approach involves rating and weighting all the identified factors, and then consolidating the rates and weights to produce an overall assessment. The weighted checklist seeks to recap all aspects of risk in a single country rating that can be readily integrated into the decision-making process.

ii. The Delphi technique involves collecting various independent opinions and then averaging and measuring the dispersion of those opinions.

iii. Quantitative analysis.

iv. Inspection visit.

v. Combination of techniques.

It has been stated that statistical approach of country risk analysis have been extensively used in past and contributed positively in emphasizing several aspects of country risk analysis. However these approaches have some limitations in issues such as specification of dependant variable, data requirement and availability.

2.4.5 Conclusion

Country risk assessment also known as country risk analysis is the process of determining a nation's ability to transfer payments. It takes into account political, economic and social factors and is used to help organisations make strategic decisions when conducting business in a country with excessive risk.

2.5 SUMMARY

This unit attempts to give an overview of the functions in as simple manner as possible.

- A PESTLE analysis studies the key external factors (Political, Economic, Sociological, Technological, Legal and Environmental) that influence an organisation. It can be used in a range of different scenarios, and can guide people professionals and senior managers in strategic decision-making.

- The Atlas of Economic Complexity attempts to measure the amount of productive knowledge that each country holds.

- Porter Diamond is a model that emphasizes the competitive advantage of an industry or business that makes it work better than other competitors in a region or country. Also known as the Porter Diamond Theory of National Advantage, the model explains why certain industries thrive in particular nations.

- To summarize, Country risk assessment is mainly about assessing a country's capability to transfer currency for foreign payments. This ability is determined by three main factors: political, economic and financial factors.

2.6 QUESTIONS FOR PRACTICE:

Objective Questions:

A) Choose the correct alternative and rewrite the statement.

i. PESTEL stands for: ______.

a. PEST Analysis b. SWOT Analysis

c. Case Analysis d. Statistical Analysis

ii. PESTLE is an analytical tool which helps to undertake ______.

a. An Internal Analysis b. An External Analysis

c. A Competitors Analysis d. A Strategic Analysis

iii. ________ is considered as political environment in PESTEL Analysis.

a. Visa requirement b. Whether and Climate

c. Age and Gender d. Interest Fluctuation

iv. Technology scanning refers to ________.

a. Strategies of multinational firms based on technologies.

b. Locating a firm's research centres in countries or regions where relevant cutting-edge research is pursued.

c. A framework for strategic planning in the knowledge economy.

d. The process of identifying technologies in the external business environment.

v. An analysis of the external environment enables a firm to identify _____.

a. Strengths and opportunities.

b. Strengths and weaknesses.

c. Weaknesses and threats.

d. Opportunities and threats.

vi. The _______ Complexity Index is a holistic measure of the productive capabilities of large economic systems, usually cities, regions, or country.

a. Economic b. Social

c. Technical d. Cultural

vii. ______ diversification is an important means to enhance economic complexity.

a. Product b. Sectorial

c. Regional d. Market

viii. The Atlas of Economic Complexity is an award-winning ________ tool that allows people to explore global trade flows across markets.

a. Data Visualization b. Data Analysis

c. Data Interpretation d. Data Clouding

ix. The Economic Complexity ______ captures significantly more growth-relevant information than the 6 World Governance Indicators, either individually or combined.

a. index b. score

c. rating d. ranking

x. The Economic Complexity Index, or ECI, is a measure of an economy's ______ which can be inferred from data connecting locations to the activities that are present in them.

a. ability b. resources

c. capacity d. performance

xi. Michael Porter has argued that _______.

a) the logic of old economy strategies remains the same for internet-based companies.

b) the internet did not bring new types of products/services or large efficiency gains.

c) the internet does not matter to global competition.

d) he internet does not help to improve company operations.

xii. The Diamond Model assumes that ____.

a) Multinational firms must develop global strategies based only on home demand conditions.

b) Multinational firms must pay less attention to global consumers than domestic consumers.

c) The national home base of a firm must be the biggest market for a multinational firm.

d) he national home base of a firm plays a key role in shaping that firm's competitive advantage in global markets.

xiii. The Diamond Model suggests that four factors determine a firm's competitive advantage:________.

a. 1) home demand conditions; 2) home supply conditions;

3) firm strategy and structure; 4) supporting industries.

b. 1) home demand and factor conditions; 2) firm strategy, structure and rivalry; 3) related industries; 4) supporting industries.

c. 1) home demand conditions; 2) home factor conditions; 3) firm strategy, structure and rivalry; 4) related and supporting industries.

d. 1) home demand conditions; 2) home supply; 3) firm strategy; 4) related and supporting industries.

xiv. Which of the following are examples of factor conditions under the Porter "diamond" model? ______

a. The presence of international competitive supplier industries.

b. The nation's stock of knowledge.

c. The demand in the home market.

d. All of the above.

xv. Michael Porter has argued that the most important determinant of a firm's profitability is ____________.

a. Conditions in the home diamond

b. Industry attractiveness

c. Economies of scale

d. Bargaining power

xvi. A risk response which involves eliminating a threat is called________.

a. Mitigation b. fluctuation

c. Avoidance d. Transfer

xvii. ______ risk primarily examines debt.

a. Sovereign b. Political

c. Legal d. Technical

xviii. ______ analysis is the study of business environment in different countries with an objective of predicting the likelihood of various kinds of risks that businesses operating in those countries may face.

a. Country risk b. operating risk

c. no operating risk d. functional risk

xix. Dumping refers to ________.

a. Reducing tariffs

b. Sale of goods abroad at low a price, below their cost and price in home market

c. Buying goods at low prices abroad and selling at higher prices locally

d. Expensive goods selling for low prices

xx. Long term securities denominated in two currencies is called as ________.

a) Foreign bonds b) Euro Dollar deposits

c) Dual Currency bonds d) Euro Bond

in different countries with an objective of predicting the likelihood of various kinds of risks that businesses operating in those countries may f

Answer Key:

i- a ii- b iii-a iv-d v- d vi-a vii- b viii- a ix-a x- c

xi- a xii- d xiii-c xiv-b xv-b xvi- d xvii- a xviii-a xix- c xx- c

B) State whether the following statements are true or false.

i. PESTLE analysis is a multi-faceted business tool.

ii. Economic factors are inclusive of both micro and macroeconomic factors.

iii. **The stability of a government is not a factor in PESTLE.**

iv. PESTLE Analysis never provide an advance warning of potential threats and opportunities.

v. A PESTEL analysis helps an organisation identify the external forces that could impact their market and analyse how they could directly impact their business.

vi. The economic complexity of a country is calculated based on the **diversity** of exports a country produces and their **ubiquity**.-

vii. Economic complexity is expressed in the composition of a country's productive output and reflects the structures that emerge to hold and combine knowledge.

viii. Economic Atlas does not relies on international trade data.

ix. The social accumulation of productive knowledge has not been a universal phenomenon.

x. the complexity of an economy is related to the multiplicity of useful knowledge embedded in it.

xi. Porter's Diamond Model used to understand the suitable measures that can be taken by the country or organization to improve its performance.

xii. Porter's diamond shows five main attributes that he claims are the key determinants of national competitive advantage.

xiii. Porter's Value Chain is a useful strategic management tool.

xiv. Michael Porter's Diamond Model is related with International Finance.

xv. Micheal Porter proposed The Diamond Model in his book **'Competitive Advantage of Nations'.**

xvi. Country risk is usually lowest in economically developed democratic countries.

xvii. In overseas markets higher returns are usually associated with high risk and low attractiveness.

xix. The Uppsala model of internationalization assumes that firms take a staged approach to internationalization.

xx. Country part risk can be eliminated by delivery v/s payment mechanism.

Answer Key: True: i, ii, v, vi, vii, ix, x, xi, xv, xvi, xix, xx

False: iii, iv, viii, xii, xiii, xiv, xvii,

C) Descriptive Questions:

1. What is PESTLE Analysis? Explain factors affecting on PESTLE Analysis.
2. Write a note on – 'Advantages and Disadvantages of PESTLE Analysis'
3. What is Atlas of Economic Complexities? Explain its importance.
4. Discuss the Porter's Diamond Model.
5. Explain the meaning and importance of Country Risk Analysis.
6. What are the techniques to assess country risk?

2.7 REFRENCES

1. Charles W.L. Hill, International Business Competing in the Global Marketplace, 4th Edition, Tata McGraw Hill, Publishing Company Limited.
2. Cherunillam Francis, International Business, Text and Cases, 3rd Edition, Prentice-Hall of India Private Limited.
3. Porter, M.E. (1990). The Competitive Advantage Of Nations. Harvard Business Review
4. Grant, R.M. (1991). Porter's Competitive Advantage Of Nations: An Assessment. Strategic Management Journal
5. Smit, A.J. (2010). The Competitive Advantage Of Nations: Is Porter's Diamond Framework A New Theory That Explains The International Competitiveness Of Countries? Southern African Business Review
6. Harvard Business Review: https://hbr.org/1990/03/the-competitive-advantage-of-nations

❄❄❄❄❄❄❄

3

CROSS CULTURAL MANAGEMENT

Unit Structure

3.0 OBJECTIVES:

1. To study the Hofstede's Cultural Dimension
2. To understand CAGE Framework Pankaj Ghemawat.
3. To Culture and Leader Effectiveness: The GLOBE Study

3.1 HOFSTEDE'S CULTURAL DIMENSION

3.1.1 Meaning

Professor Geert Hofstede conducted one of the most comprehensive studies of how values in the workplace are influenced by culture. He defines culture as "the collective programming of the mind distinguishing the members of one group or category of people from others". Hofstede's cultural dimensions theory is a framework for cross-cultural communication. It describes the effects of a society's culture on the values of its members, and how these values relate to behaviour, using a structure derived from factor analysis.

Hofstede's cultural dimensions theory is a framework for cross-cultural communication, developed by Geert Hofstede. It describes the effects of a society's culture on the values of its members, and how these values relate to behaviour, using a structure derived from factor analysis. The original theory proposed four dimensions along which cultural values could be analysed: individualism-collectivism; uncertainty avoidance; power distance (strength of social hierarchy) and masculinity-femininity (task orientation versus person-orientation).

Independent research in Hong Kong led Hofstede to add a fifth dimension, long-term orientation, to cover aspects of values not discussed in the original paradigm. In 2010 Hofstede added a sixth dimension, indulgence versus self- restraint. The theory has been widely used in several fields as a paradigm for research, particularly in cross-cultural psychology, international management, and cross-cultural communication. It continues to be a major resource in cross-cultural fields. It has inspired a number of other major cross-cultural studies of values, as well as research on other aspects of culture, such as social beliefs. Hofstede developed his original model as a result of using factor analysis to examine the results of a worldwide survey of employee values by IBM between 1967 and 1973.

3.1.2 Dimensions

The Hofstede model of national culture consists of six dimensions. The cultural dimensions represent independent preferences for one state of affairs over another that distinguish countries (rather than individuals) from each other.

The country scores on the dimensions are relative, in that we are all human and simultaneously we are all unique. In other words, culture can only be used meaningfully by comparison. The model consists of the following dimensions:

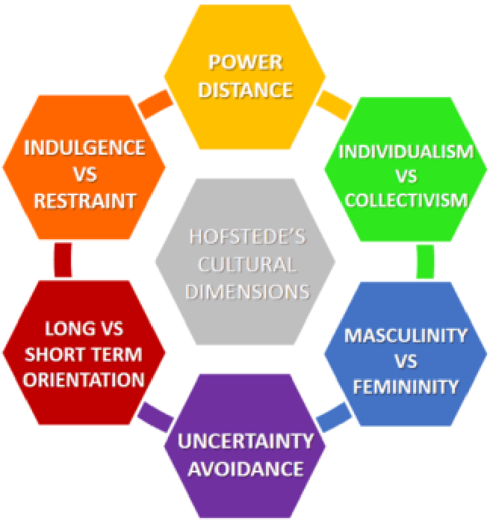


Figure 3.1: Hofstede's Cultural Dimensions

1. Power Distance:

This dimension expresses the degree to which the less powerful members of a society accept and expect that power is distributed unequally: beliefs about the appropriate distribution of power in society. The fundamental issue here is how a society handles inequalities among people. People in societies exhibiting a large degree of Power Distance accept a hierarchical order in which everybody has a place and which needs no further justification. In societies with low Power Distance, people strive to equalise the distribution of power and demand justification for inequalities of power. China and Saudi Arabia are countries with a high Power Distance index.

2. Individualism:

The Individualism/Collectivism dimension is about the relative importance of individual versus group interests. The high side of this dimension, called individualism, can be defined as a preference for a loosely-knit social framework in which individuals are expected to take care of only themselves and their immediate families. Its opposite, collectivism, represents a preference for a tightly-knit framework in society in which individuals can expect their relatives or members of a particular in-group to look after them in exchange for unquestioning loyalty. A society's position on this dimension is reflected in whether people's self-image is defined in terms of "I" or "we." The USA is considered as one of the most individualistic countries in the world.

3. Masculinity:

The Masculinity/Femininity dimension is about what values are considered more important in a society. The Masculine side of this dimension represents a preference in society for achievement, heroism, assertiveness and material rewards for success. Society at large is more competitive. Its opposite, femininity, stands for a preference for cooperation, modesty, caring for the weak and quality of life. Society at large is more consensus-oriented. In the business context Masculinity versus Femininity is sometimes also related to as "tough versus tender" cultures. Japan is considered to be a very masculine country, whereas Scandinavian countries such as Norway and Sweden are considered highly feminine.

4. Uncertainty Avoidance:

The Uncertainty Avoidance dimension expresses the degree to which the members of a society feel uncomfortable with uncertainty and ambiguity. In addition its impact on rule making is taken into account. The fundamental issue here is how a society deals with the fact that the future can never be known: should we try to control the future or just let it happen? Countries exhibiting a high Uncertainty Avoidance maintain rigid codes of belief and behaviour and are intolerant of unorthodox behaviour and ideas. These countries often need many rules to constrain uncertainty. Countries with a low Uncertainty Avoidance index maintain a more relaxed attitude in which practice counts more than principles, tolerance for ambiguity is accepted and the need for rules to constrain uncertainty is minimal. South American countries such as Chile, Peru and Argentina are highly uncertainty avoiding countries.

5. Time Orientation:

Every society has to maintain some links with its own past while dealing with the challenges of the present and the future. Societies prioritize these two existential goals differently. Countries that score low on this dimension, for example, prefer to maintain time-honoured traditions and norms while viewing societal change with suspicion. They are past and present oriented and value traditions and social obligations. Countries with cultures that scores high on this dimension on the other hand take a more pragmatic approach: they are future oriented and encourage thrift and efforts in modern education as a way to prepare for the future. Asian countries such as China and Japan are known for their long term orientation. Morocco is a short term oriented country.

6. Indulgence:

The Indulgence dimension is a relatively new dimension to the model. This dimension is defined as the extent to which people try to control their desires and impulses, based on the way they were raised. Relatively weak control is called Indulgence and relatively strong control is called Restraint. Cultures can, therefore, be described as Indulgent or Restrained. Indulgence stands for a society that allows relatively free gratification of basic and natural human drives related to enjoying life and having fun. Restraint stands for a society that suppresses gratification of needs and regulates it by means of strict social norms.

3.1.3. Application of the Theory

1. Cultural difference awareness:

Geert Hofstede shed light on how cultural differences are still significant today, in a world that is becoming more and more diverse. Hofstede's cultural dimensions can be used to help explain why certain behaviours are more or less common in different cultures. For example, individualism vs. collectivism can help explain why some cultures place more emphasis on personal achievement than others. Masculinity vs. feminism could help explain why some cultures are more competitive than others and long-term vs. short-term orientation can help explain why some cultures focus more on the future than the present (Hofstede, 2011).

2. **International communication and negotiation:**

Hofstede's cultural dimensions can also be used to predict how people from different cultures will interact with each other. For example, if two people from cultures with high levels of power distance meet, they may have difficulty communicating because they have different expectations about who should be in charge (Hofstede, 2011).

3. **In Business:**

Finally, Hofstede's cultural dimensions can be used to help businesses adapt their products and marketing to different cultures.

For example, if a company wants to sell its products in a country with a high collectivism score, it may need to design its packaging and advertising to appeal to groups rather than individuals.

Within a business, Hofstede’s framework can also help managers to understand why their employees behave the way they do.

For example, if a manager is having difficulty getting her employees to work together as a team, she may need to take into account that her employees come from cultures with different levels of collectivism (Hofstede, 2011).

3.2 CAGE FRAMEWORK PANKAJ GHEMAWAT:

3.2.1 Meaning

Pankaj “Megawatt” Ghemawat is an international strategy guru who developed the CAGE framework to offer businesses a way to evaluate countries in terms of the “distance” between them.Pankaj Ghemawat, “Distance Still Matters,” Harvard Business Review 79, no. 8 (September 2001): 1–11. In this case, distance is defined broadly to include not only the physical geographic distance between countries but also the cultural, administrative (currencies, trade agreements), and economic differences between them. As summarized in Table 3.1 "The CAGE Framework", the CAGE (cultural, administrative, geographic, and economic) framework offers a broader view of distance and provides another way of thinking about location and the opportunities and concomitant risks associated with global arbitrage.Pankaj Ghemawat, “The Forgotten Strategy,” Harvard Business Review 81, no. 11 (September 2003).

Table 3.1

The CAGE Framework

Cultural Distance	Administrative Distance	Geographic Distance	Economic Distance
Attributes Creating Distance			
Different languages	Absence of colonial ties	Physical remoteness	Differences in consumer incomes
Different ethnicities; lack of connective ethnic or social networks	Absence of shared monetary or political association	Lack of a common border	Differences in costs and quality of the following: • Natural resources • Financial resources • Human resources • Infrastructure • Intermediate inputs • Information or knowledge
Different religions	Political hostility	Lack of sea or river access	-----------
Different social norms	Government policies	Size of country	------------
------------------	Institutional weakness	Weak transportation or communication links	----------------
---------------		Differences in climates	------------
Industries or Products Affected by Distance			
Products have high-linguistic content (TV).	Government involvement is high in industries that are • producers of staple goods (electricity),	Products have a low value-of-weight or bulk ratio (cement).	Nature of demand varies with income level (cars).

Cultural Distance	Administrative Distance	Geographic Distance	Economic Distance
	• producers of other “entitlements” (drugs), • large employers (farming), • large suppliers to government (mass transportation), • national champions (aerospace), • vital to national security (telecommunications), • exploiters of natural resources (oil, mining), and • subject to high-sunk costs (infrastructure).		
Products affect cultural or national identity of consumers (foods).	———	Products are fragile or perishable (glass or fruit).	Economies of standardization or scale are important (mobile phones).
Product features vary in terms of size (cars), standards (electrical appliances), or packaging.	—————	Communications and connectivity are important (financial services).	Labor and other factor cost differences are salient (garments).
Products carry country-specific quality associations (wines).	——————	Local supervision and operational requirements are high (many services).	Distribution or business systems are different (insurance).
--------	----------	--------------	Companies need to be

Cultural Distance	Administrative Distance	Geographic Distance	Economic Distance
			responsive and agile (home appliances).

(Source: Recreated from Pankaj Ghemawat, "Distance Still Matters," Harvard Business Review 79, no. 8 (September 2001), accessed February 15, 2011,)

To apply the CAGE framework, identify locations that offer low raw material costs, access to markets or consumers, or other key decision criteria. You might, for instance, determine that you're interested in markets with strong consumer buying power, so you would use per capita income as your first sorting criterion. As a result, you would likely end up with some type of ranking. Ghemawat provides an example for the fast-food industry, where he shows that on the basis of per capita income, countries like Germany and Japan would be the most attractive markets for the expansion of a North American fast-food company. However, when he adjusts this analysis for distance using the CAGE framework, he shows that Mexico ranks as the second most attractive market for international expansion, far ahead of Germany and Japan.Pankaj Ghemawat, "Distance Still Matters," Harvard Business Review 79, no. 8 (September 2001): 1–11. Recall though, that any international expansion strategy still needs to be supported by the specific resources and capabilities possessed by the firm, regardless of the picture presented by the CAGE analysis. To understand the usefulness of the CAGE framework, consider Dell and its efforts to compete effectively in China. The vehicles it used to enter China were just as important in its strategy as its choice of geographic arena. For Dell's corporate clients in China, the CAGE framework would likely have revealed relatively little distance on all four dimensions even geographic, given the fact that many personal-computer components have been sourced from China. However, for the consumer segment, the distance was rather great, particularly on the dimensions of culture, administration, and economics. For example, Chinese consumers didn't buy over the Internet, which is the primary way Dell sells its products in the United States. One possible outcome could have been for Dell to avoid the Chinese consumer market altogether. However, Dell opted to choose a strategic alliance with distributors whose knowledge base and capabilities allowed Dell to better bridge the CAGE-framework distances. Thus the CAGE framework can be used to address the question of where (which arena) and how (by which entry vehicle) to expand internationally.

3.2.2 CAGE Analysis and Institutional Voids

While you can apply CAGE to consider some first-order distances (e.g., physical distance between a company's home market and the new foreign market) or cultural differences (e.g., the differences between home-market and foreign-market customer preferences), you can also apply it to identify institutional differences. Institutional differences include differences in political systems and in financial markets. The greater the distance, the harder it will be to operate in that country. Emerging markets in particular can have greater differences because these countries lack many of the specialized intermediaries that make institutions like financial markets work. Table 3.2 "Specialized Intermediaries within a Country or Other Geographic Arena" lists examples of specialized intermediaries for different institutions. If an institution lacks these specialized intermediaries, there is an institutional void. An institutional void refers to the absence of key specialized intermediaries found in the markets of finance, managerial talent, and products, which otherwise reduce transaction costs.

Table 3.2

Specialized Intermediaries within a Country or Other Geographic Arena

Institution	Specialized Intermediary
Financial markets	• Venture-capital firms • Private equity providers • Mutual funds • Banks • Auditors • Transparent corporate governance
Markets for managerial talent	• Management institute or business schools • Certification agencies • Headhunting firms • Relocation agencies
Markets for products	• Certification agencies • Consumer reports • Regulatory authorities (e.g., the Food and Drug Administration) • Extrajudicial dispute resolution services
All markets	• Legal and judiciary (for property rights protection and enforcement)

(**Source:** Recreated from Pankaj Ghemawat, “Distance Still Matters,” Harvard Business Review 79, no. 8 (September 2001), accessed February 15, 2011.)

3.2.3 Three Strategies for Handling Institutional Voids

When a firm detects an institutional void, it has three choices for how to proceed in regard to the potential target market: (1) adapt its business model, (2) change the institutional context, or (3) stay away.

For example, when McDonald’s tried to enter the Russian market, it found an institutional void: a lack of local suppliers to provide the food products it needs. Rather than abandoning market entry, McDonald’s decided to adapt its business model. Instead of outsourcing supply-chain operations like it does in the United States, McDonald’s worked with a joint-venture partner to fill the voids. It imported cattle from Holland and russet potatoes from the United States, brought in agricultural specialists from Canada and Europe to improve Russian farmers' management practices, and lent money to farmers so that they could invest in better seeds and equipment. As a result of establishing its own supply-chain and management systems, McDonald's controlled 80 present of the Russian fast-food market by 2010.

3.2.4 Conclusion

Developed by Professor Pankaj Ghemawat, the CAGE Distance framework identifies the Cultural, Administrative, Geographic, and Economic differences between the various countries that companies should address and take care of whilst working on and crafting international strategies. CAGE analysis can help you identify institutional voids, which might otherwise frustrate internationalization efforts. Institutional differences are important to the extent that the absence of specialized intermediaries can raise transaction costs just as their presence can reduce them. "Distance Still Matters" is an influential Harvard Business Review article. In this work, Ghemawat proposes the CAGE distance framework that allows firms to consider four dimensions of international distance (cultural, administrative, geographic, and economic) when planning global expansion.

3.3 CULTURE AND LEADER EFFECTIVENESS: THE GLOBE STUDY

3.3.1 Meaning

Globalization nowadays is far advanced in its development. Especially in the business sector we are used to consume goods from all over the world. We can buy these just around the corner and for low prices, since transport costs and production times are shrinking in times of Modernization. This is one of the reasons why collaboration and interconnection with different people from a variety of countries has got increasingly important over the last years. In comparison to earlier times, we can travel around the world in no time. Languages and cultures are often the only barriers left. This is evident when thinking about different companies working together as well as multinational corporations with subsidiaries all over the world. Accordingly, most superiors face problems when they lead employees from distinct societies and cultures. But perception of good leadership differs in various cultures.

The GLOBE study is a 10-year research program that examines the sphere of influence which varying cultures have on managerial staff and on organizational effectiveness. The word GLOBE itself is an abbreviation for 'Global Leadership and Organizational Behaviour Effectiveness'. To be able to construct and comprehend the survey-based research project GLOBE, all participants and readers should have the same understanding of the term *culture.* According to House (House et al. 2004: 15) culture is defined as follows:

‘Shared motives, values, beliefs, identities, and interpretations or meanings of significant events that result from common experiences of members of collectives that are transmitted across generations.’

This research program has continued in three different but still correlated phases (Globe Foundation: 2004 Data): The first phase corresponds with the aforementioned one released in 2004, named ‘’Culture, Leadership, and Organizations: The Globe Study of 62 Societies”. The results of the second phase were released in 2007 (“Culture and Leadership across the world: The GLOBE Book of In-Depth Studies of 25 Societies”) This research pursued the former one further with regard to more detailed portrayals of leadership qualities within the 25 cultures and recommendations for managerial behaviour towards other cultures. The findings of the latest phase three appeared in 2014 (“Strategic Leadership across Cultures: The GLOBE Study of CEO Leadership Behaviours and Effectiveness in 24 Societies”). The latter study shows the significance of CEOs matching their behaviour to the respective society’s leadership expectations (House et al. 2004: 3).

However, the Globe 2004 study is “ground breaking in scale and scope” (Globe Foundation: About the Studies). As reported by House (2004: 3) its findings are based on responses to surveys from 17,300 middle managers from 951 in the food processing, financial services and telecommunication sectors (Globe Foundation: About the Studies). That is why this paper focuses on the Globe 2004 study.

The purpose of this work is to give a short summary on the structure and on results of the GLOBE research program, as well as on a few critics’ opinions picked out of the large amount of criticism it received from others. But first the aim of such determined effort for research is explained.

3.3.2 Purpose of the GLOBE

The pivotal idea was to examine the influence of national culture on “societal, organizational, and leader effectiveness” (Hoppe 2007: 1). That way the GLOBE team established how culture and leadership are influenced by national culture (Globe Foundation: About the Studies).

The main objective of Project GLOBE is to raise human awareness and fill a considerable knowledge gap that concerns cross-cultural encounters (House et al. 2004: 3, 25-26). Thus, the objective of GLOBE’s findings is to support and benefit interactions between individuals from different cultures (House 2004: 1). These individuals for example are “negotiators, managers, members of joint ventures, or expatriates working in foreign cultures” (House et al. 2004: 7). Hence, the study’s results can be beneficial for choosing, advising, and training those individuals. Also, Managers who have to deal with persons from other cultures on a professional level can beforehand have a look at the Globe findings with respect to the most and least effective leader attributes and demeanours (House et al. 2004: 25). Above all, knowing what is regarded effective or ineffective in the other culture is likely to make problem solving easier. It helps with adapting mutual expectations and can thereby improve decision making processes, management practices and performance (House et al. 2004: 6). Moreover, GLOBE findings can be used for comparisons of cultural values, organizational, or leadership practices of a country with its trading partner or even with its significant competitors. These comparisons can help to develop strategies for enhanced commerce or more productive relationships across borders (House et al. 2004: 26).

3.3.3 Leader Effectiveness and Culture – The GLOBE Study

GLOBE examined 112 leader characteristics, such as; modest, decisive, autonomous and trustworthy, based on the following definition of leadership: an outstanding leader is a person in an organization or industry who is "exceptionally skilled at motivating, influencing, or enabling you, others, or groups to contribute to the success of the organization or task."

The first round of analysis generated 21 leadership scales, which in turn folded into six superordinate leader styles. Based on a 7-point scale and the "world mean" of each scale (i.e., the average of 61 country means), the 21 leadership scales ranked from the "most universally desirable" to "the least universally desirable" as follows:

Integrity, Inspirational, Visionary, Performance-oriented, Team-integrator, Decisive, Administratively competent, Diplomatic, Collaborative team orientation, Self-sacrificial, Modesty, Humane, Status conscious, Conflict inducer, Procedural, Autonomous, Face saver, Non-participative, Autocratic, Self-cantered , Malevolent.

These 21 leadership scales were statistically and conceptually reduced to six styles. The first two styles, charismatic/value based and team-oriented style, were seen as contributing to outstanding leadership in all cultures. However, for the other four styles, cultural variation was larger: In some cultures, they were seen as good and effective styles, while other cultures saw them as hindering outstanding leadership. Below, the six styles are listed in the order of least cultural variation to most cultural variation. We also indicate the range of ratings each style received in the different countries. The GLOBE team defined the word leadership as follows

1. **The charismatic/value based style:** indicating a motivated, passionate type of leader with high standards who firmly holds on to core values and therefore also expects a lot from others. This style also includes the attributes "visionary, inspirational, self-sacrificial, integrity, decisive, and performance-oriented".

2. **The team-oriented style:** stresses the importance of common goals and collaboration amongst team members. It encloses the attributes "collaborative team orientation, team integrator, diplomatic, (reverse scored) malevolent, and administratively competent".

3. **The participative style:** demonstrates how much leaders involve others in decision-making and implementation. It incorporates two subscales: autocratic (reverse scored) and non-participative (reverse scored).

4. **The Humane-Oriented Leadership:** points out attentive, thoughtful and supportive leadership as well as compassionate and generous leader qualities. This dimension includes modesty and humane orientation.

5. **The Self-protective leadership:** focuses on the individual and group being safe and secure with the support of rank enhancement and through maintaining the reputation. Its subscales are named “self-cantered, status-conscious, conflict inducer, face saver, and procedural”.

6. **The autonomous style:** reflects independent, individualistic, autonomous and unique leadership attributes.

3.3.4 Cultural Dimensions

They are briefly described as follows:

Uncertainty Avoidance is the level to which members of an organization feel threatened by unclear situations and thus try to alleviate unpredictability of future events.

Power Distance is the extent of societal acceptance of the unequal bedding and centring of power at higher levels of an organization. An autocratic leader is probable to not be favoured in low power distance cultures.

Collectivism I (Institutional) shows how much organizations encourage and reward collective distribution of resources and collective action.

Collectivism II (In-Group) is the level of expression of pride, loyalty, and cohesiveness of individuals.

Gender Egalitarianism is the extent to which a collective promotes and maximizes gender equality.

Assertiveness refers to how much individuals are tough, confrontational and competitive in social relationships. Less assertive cultures sympathize with the weak and appreciate solidarity and loyalty.

Future Orientation portrays the societal importance attached to future-oriented behaviours like delaying gratification, planning, and investing in the future.

Performance Orientation shows the level of encouraging and rewarding team members for performance improvement and excellence.

Humane Orientation displays the degree to which individuals are encouraged and rewarded for being fair, altruistic, generous, caring, and kind.

3.3.5 Conclusion

The Global Leadership and Organizational Behaviour Effectiveness (GLOBE) project provides leaders with an additional lens through which they can better understand how to perform well in an international environment. While the Hofstede framework was developed in the 1960s, the GLOBE project developed in the 1990s is a more recent attempt to understand cultural dimensions

Harry Triandis, one of the giants in cross-cultural research calls the GLOBE research "the Manhattan Project of the study of the relationship of culture to conceptions of leadership" (2004). There are a number of reasons for this assessment. GLOBE is the most comprehensive study to date that empirically researched the relationship between culture and leader behaviour in so many societies, with so many different quantitative and qualitative measures and methods, and in so many different organizations. It did so by engaging more than 170 collaborators from around the world who brought to the project an in-depth understanding of their own culture and its notion and practice of leadership.

3.5 SUMMARY

This unit attempts to give an overview of the functions in as simple manner as possible.

- Hofstede developed this cultural model primarily on the basis of differences in values and beliefs regarding work goals. Hofstede's framework is especially useful because it provides important information about differences between countries and how to manage such differences.
- Pankaj “Megawatt” Ghemawat is an international strategy guru who developed the CAGE framework to offer businesses a way to evaluate countries in terms of the “distance” between them.
- CAGE analysis asks you to compare a possible target market to a company’s home market on the dimensions of culture, administration, geography, and economy. CAGE analysis yields insights in the key differences between home and target markets and allows companies to assess the desirability of that market.

3.6 QUESTIONS FOR PRACTICE:

Objective Questions:

A) Choose the correct alternative and rewrite the statement.

i. Compared to so-called Western cultures, most of Asian cultures are found by G. Hofstede to exhibit ______.

a. low power distance and high collectivism

b. high power distance and low collectivism

c. low power distance and low collectivism

d. high power distance and high collectivism

ii. According to Hofstede, ________ dimension of a national culture measures the acceptability of a large difference in status and power among its citizens.

a. Individualism versus collectivism

b. Uncertainty avoidance

c. Power distance

d. Masculinity versus femininity

iii. _______ dimensions of Hofstede used to define differences between national cultures refers to the degree to which members of a culture are expected to act independently of other members.

a. Individualism b. Power distance

c. Masculinity d. Uncertainty avoidance

iv. According to Hofstede's initial study, there are four dimensions of difference between national cultures. Which of the following is not one of the dimensions Hofstede studied? __

a. Uncertainty avoidance b. Power distance

c. Masculinity d. Paradoxically

v. Hofstede’s dimensions of culture were based on a study at ______.

a. IBM. b. Intel Ltd

c. Pepsi d. Google

vi. _______ is not the component of CAGE Framework.

a. Economic b. Social

c. Geographic d. Cultural

vii. ________ refers to the differences of cultures between the target and home countries.

a. Cultural Closeness b. Cultural differences

c. Cultural Distance d. Cultural dimension

viii. __________ is an influential Harvard Business Review article.

a. Distance Still Matters b. Data Still Matters

c. Data Interpretation Matters d. Distance No Matters

ix. The _______ framework serves managers as a conceptually unifying analysis tool that contributes to their understanding of the main levers that help to create a sustainable competitive advantage.

a. value-creation b. value-addition

c. value-process d. value-extension

x. Professor Pankaj Ghemawat assesses data from companies such as to show that corporations are missing opportunities to be truly global.

a. HSBC and BMW b. HDFC and BMW

c. HSBC and HUL d. HDFC and HUL

xi. GLOBE measured _______different ideas of the characteristics of outstanding leaders, thereby providing the largest information base for cross-cultural leadership ever.

a. Socially b. culturally

c. economically d. environmentally

xii. GLOBE established ____ cultural dimensions that make it possible to capture the similarities and/or differences in norms and values.

a) 9 b) 7 c) 8 d) 5

xiii. ______ refers to extent to which a society, organization, or group relies on social norms, rules, and procedures to alleviate unpredictability of future events.

a. Uncertainty Avoidance b. Humane Orientation

c. Assertiveness d. Future Orientation

xiv. _____ refers to the degree to which a collective encourages and rewards group members for performance improvement and excellence. The presence of international competitive supplier industries.

a. Gender Egalitarianism b. Humane Orientation

c. Performance Orientation d. Assertiveness

xv. _______ leadership style encourages input from others in decision-making and implementation; and emphasizes delegation and equality.

a. participative style b. value based

c. charismatic style d. team-oriented style

an objective of predicting the likelihood of various kinds of risks that businesses operating in those countries may f

Answer Key:

i- d ii- c iii-a iv-d v- a vi-b vii- c viii- a ix-c x- a

xi- b xii- a xiii-a xiv-c xv-a

B) State whether the following statements are true or false.

i. International marketers must understand many subtle differences that may affect the way their marketing is made and perceived in foreign markets.

ii. Cultural dimensions have widely accepted as an important explanation source of the differences in organisational structure and management practice in different countries.

iii. In 2010 Hofstede added a sixth dimension i.e. indulgence versus self- restraint.

iv. A low degree of the Index indicates that hierarchy is clearly established and executed in society, without doubt, or reason.

v. indulgence is defined as a society that allows relatively free gratification of basic and natural human desires related to enjoying life and having fun.

vi. Pankaj Ghemawat cage framework illustrates the degree of difference between the two countries, has to do with their distance from each other.

vii. The CAGE Distance Framework identifies Cultural, Administrative, Geographic and Economic differences or distances between countries that companies should address when crafting international strategies.

viii. CAGE analysis does not yield insights in the key differences between home and target markets

ix. in case of Power Distance people of the country give more importance to the materialistic pleasures of life or strong emphasis is on the interpersonal relationships.

x. Ghemawat grouped CAGE factors into four broad categories that are responsible for the CAGE acronym: Cultural, Administrative, Geographic, and Economic.

xi. GLOBE speaks of societies rather than countries, as their data showed that some countries are fractioned into rather different cultural groups.

xii. GLOBE's first major achievement is a comprehensive description of how cultures are different or similar from one another.

xiii. Uncertainty avoidance means the degree to which a collective encourages and rewards individuals for being fair, altruistic, generous, caring, and kind to others.

xiv. GLOBE examined 112 leader characteristics.

xv. The differences in cultural acceptance of the different leader styles does not manifest in concrete behaviours.

Answer Key: True: i, ii, iii, v, vi, vii, xi, X, xii, xiv,

False: iv, viii, ix, xiii, xv,

C) Descriptive Questions:

1. Explain the dimensions of Hofstede's Cultural Dimension.
2. Discuss the various applications of Hofstede's Cultural Dimension in international business.
3. What is the main purpose of the GLOBE Study in International Business?
4. What are the Cultural dimensions of GLOBAL Study to be demonstrated?
5. Explain the impact of GLOBE Study on Leadership.

6. Explain the Culture and Leader Effectiveness in the GLOBE Study
7. Explain what distance is in relation to the CAGE framework.
8. What are the key elements in CAGE analysis?
9. What is an institutional void? How might CAGE analysis help you identify institutional voids?

2.7 REFRENCES

1. Charles W.L. Hill, International Business Competing in the Global Marketplace, 4th Edition, Tata McGraw Hill, Publishing Company Limited.
2. Cherunillam Francis, International Business, Text and Cases, 3rd Edition, Prentice-Hall of India Private Limited.
3. Dorfman, P., Hanges, P. J., & Brodbeck, F. C. (2004). Leadership and cultural variation: The identification of culturally endorsed leadership profiles. In R. J. House, P.J. Hanges, M. Javidan, P. W. Dorfman, & V. Gupta (Eds.). Culture, Leadership and Organizations (669-720). Sage Publications.
4. Javidan, M., Dorfman, P.W. Sully de Luque, M. & House, R.J. (2006). In the eye of the beholder: Cross-cultural lessons in leadership for project GLOBE. The Academy of Management Perspectives, February, 20(1), 67–90.
5. Mariadoss, B. J. (2017). Global Market Opportnity Assessment – Cage Analysis. Core principles of international marketing [Pressbooks edition]. CC BY NC SA 3.0. Washington State University. https://opentext.wsu.edu/mktg360/chapter/6-3-selecting-target-markets-and-target-market-strategies.
6. Pankaj Ghemawat, “Distance Still Matters,” Harvard Business Review 79, no. 8 (September 2001): 1–11.

❄❄❄❄❄❄❄

4

MODES OF ENTRY INTERNATIONAL BUSINESS

Unit Structure

4.0 OBJECTIVES

- To study the meaning of Modes of entry in International Business
- To understand various modes of entry in International Business
- To understand the nature of Strategic Alliances
- To understand the nature of Joint Venture
- To understand the nature of Merger and Acquisition

4.1 INTRODUCTION

This Unit introduces you to the study of international business and you'll begin to learn what makes international business such an essential subject for students around the world. Because international business is a vital ingredient in strategic management and entrepreneurship, this book uses these complementary perspectives to help you understand international business. Managers, entrepreneurs, workers, for-profit and non-profit organizations, and governments all have a vested interest in understanding and shaping global business practices and trends.

The mode of entry is the path or the channel set by a company to enter into the international market. Many alternative modes of entry are available for an organization to choose from and expand its business.

4.2 VARIOUS MODES OF ENTRY IN INTERNATIONAL MARKET

1. Exporting:

Exporting is the marketing and direct sale of domestically produced goods in another 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.

Exporting is a 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. The advantage of this mode of entry is that firms avoid the expense of establishing operations in the new country. Firms must, however, have a way to distribute and market their products in the new country, which they typically do through contractual agreements with a local company or distributor. When exporting, the firm must give thought to labelling, packaging, and pricing the offering appropriately for the market. In terms of marketing and promotion, the firm will need to let potential buyers know of its offerings, be it through advertising, trade shows, or a local sales force.

Because the cost of exporting is lower than that of the other entry modes, entrepreneurs and small businesses are most likely to use exporting as a way to get their products into markets around the globe. Even with exporting, firms still face the challenges of currency exchange rates. While larger firms have specialists that manage the exchange rates, small businesses rarely have this expertise.

2. Licensing and Franchising

A company that wants to get into an international market quickly while taking only limited financial and legal risks might consider licensing agreements with foreign companies. An international licensing agreement allows a foreign company (the licensee) to sell the products of a producer (the licensor) or to use its intellectual property (such as patents, trademarks, copyrights) in exchange for royalty fees. Here's how it works: You own a company in the United States that sells coffee-flavoured popcorn. You're sure that your product would be a big hit in Japan, but you don't have the resources to set up a factory or sales office in that country. You can't make the popcorn here and ship it to Japan because it would get stale. So you enter into a licensing agreement with a Japanese company that allows your license to manufacture coffee-flavoured popcorn using your special process and to sell it in Japan under your brand name. In exchange, the Japanese licensee would pay you a royalty fee.

Licensing essentially permits a company in the target country to use the property of the licensor. Such property is usually intangible, such as trademarks, patents, and production techniques. The licensee pays a fee in exchange for the rights to use the intangible property and possibly for technical assistance as well.

Because little investment on the part of the licensor is required, licensing has the potential to provide a very large return on investment. However, because the licensee produces and markets the product, potential returns from manufacturing and marketing activities may be lost. Thus, licensing reduces cost and involves limited risk. However, it does not mitigate the substantial disadvantages associated with operating from a distance. As a rule, licensing strategies inhibit control and produce only moderate returns.

3. Contract Manufacturing and Outsourcing:

Because of high domestic labor costs, many U.S. companies manufacture their products in countries where labor costs are lower. This arrangement is called international contract manufacturing or outsourcing. A U.S. company might contract with a local company in a foreign country to manufacture one of its products. It will, however, retain control of product design and development and put its own label on the finished product. Contract manufacturing is quite common in the U.S. apparel business, with most American brands being made in a number of Asian countries, including China, Vietnam, Indonesia, and India.

In twenty-first-century information technology, nonmanufacturing functions can also be outsourced to nations with lower labor costs. U.S. companies increasingly draw on a vast supply of relatively inexpensive skilled labor to perform various business services, such as software development, accounting, and claims processing. For years, American insurance companies have processed much of their claims-related paperwork in Ireland. With a large, well-educated population with English language skills, India has become a centre for software development and customer-call centres for American companies.

4. Partnerships and Strategic Alliances:

Another way to enter a new market is through a strategic alliance with a local partner. A strategic alliance involves a contractual agreement between two or more enterprises stipulating that the involved parties will cooperate in a certain way for a certain time to achieve a common purpose. To determine if the alliance approach is suitable for the firm, the firm must decide what value the partner could bring to the venture in terms of both tangible and intangible aspects. The advantages of partnering with a local firm are that the local firm likely understands the local culture, market, and ways of doing business better than an outside firm. Partners are especially valuable if they have a recognized, reputable brand name in the country or have existing relationships with customers that the firm might want to access. For example, Cisco formed a strategic alliance with Fujitsu to develop routers for Japan. In the alliance, Cisco decided to co-brand with the Fujitsu name so that it could leverage Fujitsu's reputation in Japan for IT equipment and solutions while still retaining the Cisco name to benefit from Cisco's global reputation for switches and routers.7 Similarly, Xerox launched signed strategic alliances to grow sales in emerging markets such as Central and Eastern Europe, India, and Brazil.

Strategic alliances and joint ventures have become increasingly popular in recent years. They allow companies to share the risks and resources required to enter international markets. And although returns also may have to be shared, they give a company a degree of flexibility not afforded by going it alone through direct investment.

There are several motivations for companies to consider a partnership as they expand globally, including (a) facilitating market entry, (b) risk and reward sharing, (c) technology sharing, (d) joint product development, and (e) conforming to government regulations. Other benefits include political connections and distribution channel access that may depend on relationships.

Such alliances often are favourable when (a) the partners' strategic goals converge while their competitive goals diverge; (b) the partners' size, market power, and resources are small compared to the industry leaders; and (c) partners are able to learn from one another while limiting access to their own proprietary skills.

5. Acquisitions:

An acquisition is a transaction in which a firm gains control of another firm by purchasing its stock, exchanging the stock for its own, or, in the case of a private firm, paying the owners a purchase price. In our increasingly flat world, cross-border acquisitions have risen dramatically. In recent years, cross-border acquisitions have made up over 60 percent of all acquisitions completed worldwide. Acquisitions are appealing because they give the company quick, established access to a new market. However, they are expensive, which in the past had put them out of reach as a strategy for companies in the undeveloped world to pursue. What has changed over the years is the strength of different currencies. The higher interest rates in developing nations has strengthened their currencies relative to the dollar or euro. If the acquiring firm is in a country with a strong currency, the acquisition is comparatively cheaper to make. As Wharton professor Lawrence G. Hrebiniak explains, “Mergers fail because people pay too much of a premium. If your currency is strong, you can get a bargain.”

When deciding whether to pursue an acquisition strategy, firms examine the laws in the target country. China has many restrictions on foreign ownership, for example, but even a developed-world country like the United States has laws addressing acquisitions. For example, you must be an American citizen to own a TV station in the United States. Likewise, a foreign firm is not allowed to own more than 25 percent of a US airline.

Acquisition is a good entry strategy to choose when scale is needed, which is particularly the case in certain industries (e.g., wireless telecommunications). Acquisition is also a good strategy when an industry is consolidating. Nonetheless, acquisitions are risky. Many studies have shown that between 40 percent and 60 percent of all acquisitions fail to increase the market value of the acquired company by more than the amount invested.

6. Foreign Direct Investment and Subsidiaries:

Foreign direct investment refers to the formal establishment of business operations on foreign soil—the building of factories, sales offices, and distribution networks to serve local markets in a nation other than the company’s home country. On the other hand offshoring occurs when the facilities set up in the foreign country replace U.S. manufacturing facilities and are used to produce goods that will be sent back to the United States for sale. Shifting production to low-wage countries is often criticized as it results in the loss of jobs for U.S. workers.

FDI is generally the most expensive commitment that a firm can make to an overseas market, and it’s typically driven by the size and attractiveness of the target market. For example, German and Japanese automakers, such as BMW, Mercedes, Toyota, and Honda, have made serious commitments to the U.S. market: most of the cars and trucks that they build in plants in the South and Midwest are destined for sale in the United States.

7. Joint Venture:

An organisation may choose a joint venture as their foreign market entry mode for a number of different reasons, for example: to divide the risk with other parties, to leverage of each other's strengths etc. However if a joint venture is to be successful the two or more organisations that form the joint venture must/should have common objectives in regards to: the market of entry, acceptable levels of risk/reward of the market entered, the sharing of technology, joint product development and the following of local government laws. Joint ventures often thrive if the following conditions are present between the partners: converging goals, small market share compared to the market leader, and are able to learn from one another without surrendering their competitive advantage or intellectual property.

Under the right circumstances, a joint venture can allow an organisation to gain access to a new market which it previously wouldn't have been able to do so by itself. The main restriction in this situation is generally the local government. A local government may choose to impose restrictions on wholly owned foreign investment for a number of reasons, such as: threat to local players, threat to the environment, threat to the long term prosperity of the industry etc. A real life example of this is Singapore Airlines entering the Indian market. The Indian government imposes restrictions on foreign airlines entering the local airline industry as a wholly owned subsidiary. However Singapore Airlines entered a joint venture with the Tata group, and owns a 49% stake in the SIA/Tata alliance. Whilst SIA wanted to enter the Indian domestic airline market with maximum presence, entering as a wholly owned subsidiary was not possible. Entering as a joint venture in this situation was the best entry mode for SIA as it allowed maximum exposure, maximum commitment, maximum flexibility and maximum potential rewards.

4.3 Strategic Alliances

4.3.1 Meaning

"Strategic" may be an overused word in business today, but in the world of corporate alliances, it carries a special weight. A strategic alliance is formed when two or more companies join forces to achieve a mutual benefit. Strategic alliances happen when two or more businesses work together to create a win-win situation. The idea is to help both partners share knowledge, pool resources and add profit to their bottom lines. 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, and core competencies to generate mutual interests in designing, manufacturing, or distributing goods or services.

4.3.2 Types of Strategic Alliances

There are three types of strategic alliances: Joint Venture, Equity Strategic Alliance, and Non-equity Strategic Alliance.

1. **Joint Venture:**

   A joint venture is established when the parent companies establish a new child company. For example, Company A and Company B (parent companies) can form a joint venture by creating Company C (Child Company).

   In addition, if Company A and Company B each own 50% of the child company, it is defined as a 50-50 Joint Venture. If Company A owns 70% and Company B owns 30%, the joint venture is classified as a Majority-owned Venture.

2. **Equity Strategic Alliance:**

   An equity strategic alliance is created when one company purchases a certain equity percentage of the other company. If Company A purchases 40% of the equity in Company B, an equity strategic alliance would be formed.

3. **Non-equity Strategic Alliance:**

   A non-equity strategic alliance is created when two or more companies sign a contractual relationship to pool their resources and capabilities together.

4.3.3 Advantages of strategic alliances

1. **Sharing resources and expertise.** A strategic alliance should combine the best both companies have to offer. This can be a deeper understanding of the product, sales, or marketing knowledge, or even just more hands on deck to increase speed to market.

2. **Drive innovation.** With the right alliance, partners can outpace the competition with new solutions that are a complete package for their customers. These alliances are creative and revolutionary and change the market landscape in a dramatic way.

3. **Expanded production.** When it comes to manufacturing and distributing products, strategic alliances allow partners to increase their capabilities and scale quickly to meet demand.

4. **New-market penetration.** In some cases, a strategic alliance gives access to new markets with a solution that wouldn't have been possible for either company on their own. For instance, companies going global often work with a trusted local partner to get an advantage in an emerging market.

5. **Reducing Manufacturing Costs.** Companies may also reduce costs throug strategic alliances with suppliers or customer reaching

agreements to supply products or services for longer periods and working together, meet customers' needs, each partner may apply its expertise, and benefits may be shared in the form of lower costs or new products.

6. **Developing and Diffusing Technology.** Alliances may also be used to build jointly on the technical expertise of two or more companies in developing products technologically beyond the capability of the companies acting independently. Not all companies can provide the technology that they need to effectively compete in their markets on their own. Therefore, they are teaming up with other companies who do have the resources to provide the technology or who can pool their resources so that together they can provide the needed technology. Both sides receive benefit from the partnership.

7. **Ensure Competitive Advantage**. For many small companies the only way they can stay competitive and even survive in today's technologically advanced, ever-changing business world is to form an alliance with another company. Small companies can realize the mutual benefits they can derive from strategic alliances in areas such as marketing, distribution, production, research and development, and outsourcing.

4.3.4 Disadvantages of strategic alliances

1. **Loss of control.** In an alliance, both organizations must cede some control over how their business is run and perceived. A strategic alliance requires honesty and transparency, but that trust isn't built overnight. Without significant buy-in from both parties, an alliance may suffer.

2. **Increased liability.** In a joint venture or equity strategic alliance, both companies are on the hook for the outcome. If something happens to stall production or create unhappy customers, both partners are at risk for the loss in reputation. For instance, in the case of Tesla and Panasonic, what was originally an advantageous relationship became fraught when batteries weren't produced and shipped quickly enough, causing delays in Tesla vehicle production and shipments. Reports now say that Tesla is putting its capital behind building its own battery technology to reduce dependence on Panasonic.

3. **Problems of Coordination and Loss of Agility** Alliance firms, however, are likely to suffer from delays in solutions due to problems of coordination and an alert competitor may exploit this weakness in-built in any alliance to its great advantage. The competitor could use a combination of strategies which exploit the weakness of all the alliance partners timing it in such a way that the weakness of one alliance partner is exploited quickly before another alliance partner comes to its rescue to defend the alliance.

4. **Difficulty in Managing Alliances**. Strategic alliance is a relatively new concept in management. It is also more difficult to manage, and

hence may lead to failure of strategic alliances formed even by excellent firms. A failure would mean loss of time, money, material, information, reputation, status, technological superiority, competitive position, and financial position.

5. **Loss of Autonomy.** The firm gets committed not only to a goal of its own but that of its alliance partner. This involves cost in terms of goal displacement. The firm also loses the autonomy and hence its ability to unilaterally control the outcomes. All the partners in an alliance have control over the performance of the assigned tasks. No partner, hence, can unilaterally control the outcome of an alliance activity.

4.3.5 Conclusion:

From software to steel, aerospace to apparel, the pace of strategic alliances worldwide is accelerating. A strategic alliance is an agreement between firms to do business together in ways that go beyond normal company-to-company dealings, but fall short of a merger or a full partnership. Strategic alliances can be as simple as two companies sharing their technological and/or marketing resources. In contrast, they can be highly complex, involving several companies, located in different countries. Strategic alliances are becoming more and more prominent in the global economy. Strategic alliances enable business to gain competitive advantage through access to a partner's resources, including markets, technologies, capital and people. Teaming up with others adds complementary resources and capabilities, enabling participants to grow and expand more quickly and efficiently. Strategic alliances also benefit companies by reducing manufacturing costs, and developing and diffusing new technologies rapidly. Any firm opting for strategic alliance incurs certain costs and risks compared to a firm going alone. These risks include the loss of operational control and confidentiality of proprietary information and technology. In addition, the parties may deprive themselves of future business opportunities with competitors of their strategic partner. Alliances also raise the spectre of potential conflicts, loss of autonomy, difficulties in coordination and management, mismatch of cultures, etc.

4.4 JOINT VENTURE

4.4.1 Introduction

Joint Venture is a business preparation in which more than two organizations or parties share the ownership, expense, return of investments, profit, governance, etc. To gain a positive synergy from their competitors, various organizations expand either by infusing more capital or by the medium of Joint Ventures with organizations. Joint Ventures can be with a company of same industry or can be of some other industry, but with a combination of both, they will generate a competitive advantage over other players in the market.

In short, when two or more organizations join hands together for creating synergy and gain a mutual competitive advantage, the new entity is called a

Joint Venture. It can be a private company, public company or even a foreign company. In India, many companies underwent joint venture with various foreign companies, which were either technologically more advanced or geographically more scattered. The major joint ventures in India were done in sectors like Insurance, Banking, Commercial Transport vehicle, etc.

4.4.2 Advantages of Joint Venture

1. **Economies of Scale**

   Joint Venture helps the organizations to scale up with their limited capacity. The strength of one organization can be utilized by the other. This gives the competitive advantage to both the organizations to generate economies of scalability.

2. **Access to New Markets and Distribution Networks**

   When one organization enters into joint venture with another organization, it opens a vast market which has a potential to grow and develop. For example, when an organization of United States of America enters into a joint venture with another organization based at India, then the company of United States has an advantage of accessing vast Indian markets with various variants of paying capacity and diversification of choice.

   At the same time, the Indian company has the advantage to access the markets of the United States which is geographically scattered and has good paying capacity where the quality of the product is not compromised. Unique Indian products have big markets across the globe.

3. **Innovation:**

   Joint ventures give an added advantage to upgrading the products and services with respect to technology. Marketing can be done with various innovative platforms and technological up gradation helps in making good products at efficient cost. International companies can come up with new ideas and technology to reduce cost and provide better quality products.

4. **Low Cost of Production:**

   When two or more companies join hands together, the main motive is to provide the products at a most efficient price. And this can be done when the cost of production can be reduced or cost of services can be managed. A genuine joint venture aims at this only to provide best products and services to its consumers.

5. **Brand Name:**

   A separate brand name can be created for the Joint Venture. This helps in giving a distinctive look and recognition to the brand. When two parties enter into a joint venture, then goodwill of one company which is already established in the market can be utilized by another organization for gaining a competitive advantage over other players in the market.

For example, a big brand of Europe enters into a joint venture with an Indian company will give a synergic advantage as the brand is already established across the globe.

6. Access to Technology:

Technology is an attractive reason for organizations to enter into a joint venture. Advanced technology with one organization to produce superior quality of products saves a lot of time, energy, and resources. Without the further investment of huge amount again to create a technology which is already in existence, the access to same technology can be done only when companies enter into joint venture and give a competitive advantage.

4.4.3 Disadvantages of Joint Venture

1. Clash of Culture

A joint venture brings in people with different cultures to work together. Although it has the potential to provide innovative solutions to the workplace, it has some drawbacks. Some employees are not willing to compromise and resistant to change. As a result, there may be cultural differences among the organizations.

2. Decision making –

Trust is vital in any joint venture, which can make decision-making more difficult if both parties need to sign off decisions when there is a lack of trust. Poor decision-making and second-guessing the other party can lead to failure.

3. Restricted Flexibility

When flexibility is restricted in a joint venture, all parties must focus on the objectives; otherwise, the consequences could harm their own businesses.

4. Imbalance of Expertise

An imbalance of resources, investment, or expertise is common in a joint venture. This can lead to resentment and have negative consequences if not properly handled.

5 Lack of Communication

While there is a shared business objective, joint venture partners may have other goals that can influence the joint venture. A lack of clear communication between partners can spell failure for the joint venture.

6. Privacy and information sharing

A joint venture invariably involves some degree of knowledge sharing, which can result in a loss of control over your intellectual property. Non-disclosure agreements should be in place from the start to prevent trade secrets or other sensitive corporate information from becoming public.

4.5 MERGER AND ACQUISITION

4.5.1 Meaning

Mergers and acquisitions (M&A) are defined as consolidation of companies. Differentiating the two terms, Mergers is the combination of two companies to form one, while Acquisitions is one company taken over by the other. M&A is one of the major aspects of corporate finance world. The reasoning behind M&A generally given is that two separate companies together create more value compared to being on an individual stand. With the objective of wealth maximization, companies keep evaluating different opportunities through the route of merger or acquisition.

4.5.2 Types of Merger

1. Horizontal Mergers:

Also referred to as a ‘horizontal integration’, this kind of merger takes place between entities engaged in competing businesses which are at the same stage of the industrial process. A horizontal merger takes a company a step closer towards monopoly by eliminating a competitor and establishing a stronger presence in the market. The other benefits of this form of merger are the advantages of economies of scale and economies of scope. These forms of merger are heavily scrutinized by the Competition Commission of India (“CCI”).

2. Vertical Mergers:

Vertical mergers refer to the combination of two entities at different stages of the industrial or production process. For example, the merger of a company engaged in construction business with a company engaged in production of brick or steel would lead to vertical integration. Companies stand to gain on account of lower transaction costs and synchronization of demand and supply. Moreover, vertical integration helps a company move towards greater independence and self-sufficiency.

3. Congeneric Mergers:

A congeneric merger is a type of merger where two companies are in the same or related industries or markets but do not offer the same products. In a congeneric merger, the companies may share similar distribution channels, providing synergies for the merger. The acquiring company and the target company may have overlapping technology or production systems, making for easy integration of the two entities. This type of merger is often resorted to by entities who intend to increase their market shares or expand their product lines.

4. **Conglomerate Mergers:**

   A conglomerate merger is a merger between two entities in unrelated industries. The principal reason for a conglomerate merger is utilization of financial resources, enlargement of debt capacity, and increase in the value of outstanding shares by increased leverage and earnings per share, and by lowering the average cost of capital. A merger with an unrelated business also helps the company to foray into diverse businesses without having to incur large start-up costs normally associated with a new business.

5. **Cash Merger:**

   In a 'cash merger', also known as a 'cash-out merger', the shareholders of one entity receives cash instead of shares in the merged entity. This is effectively an exit for the cashed-out shareholders.

6. **Triangular Merger:**

   A triangular merger is often resorted to, for regulatory and tax reasons. As the name suggests, it is a tripartite arrangement in which the target merges with a subsidiary of the acquirer. Based on which entity is the survivor after such merger, a triangular merger may be forward (when the target merges into the subsidiary and the subsidiary survives), or reverse (when the subsidiary merges into the target and the target survives).

4.5.3 Reasons for Mergers and Acquisitions

- Financial synergy for lower cost of capital
- Improving company's performance and accelerate growth
- Economies of scale
- Diversification for higher growth products or markets
- To increase market share and positioning giving broader market access
- Strategic realignment and technological change
- Tax considerations
- Undervalued target
- Diversification of risk

4.5.4 Advantages of Mergers and Acquisitions

1. **Improved Economic Scale:**

   A new large business or a business that has acquired another company generally has increased needs in terms of materials and supplies. And when a business has high demands, it means it has a high purchasing power. A high purchasing power enables a company to negotiate bulk orders, and when a business is able to negotiate bulk orders, it results in cost efficiency. In other words, by purchasing supplies and materials at higher volumes, a company is able to improve its scale.

2. Enhanced Distribution Capacities:

A merger or an acquisition may result in a business expanding geographically, which would, in turn, increase the business's ability to distribute goods or services to more people.

3. Increased Market Share:

When two businesses operating in the same industry become one, or when a company acquires another company operating in the same industry, the new or larger company gets to enjoy a greater market share.

4. More Financial Resources:

When two companies merge or when a company acquires another company, it results in two companies pooling their financial resources, and that can result in, among other things, a business being able to reach more customers because of a larger marketing budget.

5. Expands business into new geographic areas:

A company seeking to expand its business in a certain geographical area may merge with another similar company operating in the same area to get the business started.

6. Avoids replication:

Some companies producing similar products may merge to avoid duplication and eliminate competition. It also results in reduced prices for the customers.

4.5.5 Disadvantages of a Merger

1. Raises prices of products or services:

A merger results in reduced competition and a larger market share. Thus, the new company can gain a monopoly and increase the prices of its products or services.

2. Creates gaps in communication:

The companies that have agreed to merge may have different cultures. It may result in a gap in communication and affect the performance of the employees.

3. Creates unemployment:

In an aggressive merger, a company may opt to eliminate the underperforming assets of the other company. It may result in employees losing their jobs.

4. **Prevents economies of scale:**

   In cases where there is little in common between the companies, it may be difficult to gain synergies. Also, a bigger company may be unable to motivate employees and achieve the same degree of control. Thus, the new company may not be able to achieve economies of scale.

5. **Increased legal costs:**

   Merging two companies is a legal business transaction that often requires the involvement of several key professionals. Those involved will typically have to bring in lawyers who specialize in this type of deal, as well as financial professionals who can assist with the assets and other financial details. The legal costs associated with merging and acquiring can be high.

6. **Potentially lost opportunities:**

   The time, energy and money that goes into a merger or acquisition could require the businesses involved to forego other potential opportunities. Though, if a company allocates its resources correctly, it can assign one team of employees and experts to oversee the merger while other employees within the company can focus on other opportunities. A company may also deem the advantages it can experience from this business decision more valuable than other potential opportunities it may lose.

4.5.6 Conclusion

Although mergers and acquisitions are considered synonyms, both business combinations are different in their own ways. A company needs to understand the process and the resulting advantages and disadvantages well to appreciate the complexities involved.

4.6 SUMMARY

This unit attempts to give an overview of the functions in as simple manner as possible.

- Market entry strategies provide businesses with a roadmap to enter into international markets. Since there are many methods companies can use to sell their goods globally, they will choose the best approach based on their goals and target market.

- A strategic alliance 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.

- Some companies attempt to minimize the risk of entering an international market by creating joint ventures with other companies that plan to sell in the global marketplace. Since joint ventures often function like large, independent companies rather than a combination of two smaller companies, they have the potential to earn more revenue than individual companies. This market entry strategy carries the risk of an imbalance in company involvement, but both parties can work together to establish fair processes and help prevent this issue.

- Mergers and acquisitions, or M&A for short, involves the process of combining two companies into one. The goal of combining two or more businesses is to try and achieve synergy – where the whole (new company) is greater than the sum of its parts (the former two separate entities)

4.7 QUESTIONS:

(A) Choose the correct alternative from below and complete the statements.

1. In which of the following modes of entry, does the domestic manufacturer give the right to use intellectual property such as patent and trademark to a manufacturer in a foreign country for a fee : __________

   a. Licensing b. Contract manufacturing

   c. Joint venture d. Acquisition

2. Outsourcing a part of or entire production and concentrating on marketing operations in international business is known as ________.

   a. Licensing b. Franchising

   c. Contract manufacturing d. Joint venture

3. Which of the following is not an advantage of exporting? _________.

   a. Easier way to enter into international markets

   b. Comparatively lower risks

   c. Limited presence in foreign markets

   d. Less investment requirements

4. Which one of the following modes of entry brings the firm closer to international markets? __

   a. Licensing b. Franchising

   c. Contract manufacturing d. Joint venture

5. Franchising involves ________.

   a) the transfer of patented information and trademarks, information and know-how as well as information needed to sell a product or service.

   b) the use of franchising for licensing new technologies in global markets.

   c) the transfer of a business concept, with corresponding operational guidelines, to non-domestic parties for a fee.

   d) greenfield investment in a completely new facility, or acquisition of or merger with an already established local firm.

6. Horizontal and Vertical are types of ________.

   a. Greenfield strategy b. Licensing and franchising

   c. Mergers and acquisitions d. Greenfield investments

7. Which one of the following modes of entry permits greatest degree of control over overseas operations? _____

   a. Wholly owned subsidiary b. Contract manufacturing

   c. Joint venture d. Licensing/franchising

8. A strategic alliance is ______.

   a. Collaborative arrangement where companies join forces to defeat mutual competitive rivals

   b. Involves two or more companies joining forces to pursue vertical integration.

   c. Is a formal agreement between two or more companies in which there is strategically relevant collaboration of some sort, joint contribution of resources, shared risk, shared control and mutual dependence.

   d. All the above.

9. Strategic alliances can create economic value through helping firms improve their current operations by _______.

   a. Facilitating the development of technology standards

   b. Facilitating tacit collusion

   c. Exploiting economics of scale

   d. Managing uncertainty

10. An alliance between a supplier and a buyer that agree to use and share skills and capabilities in the supply chain, is called _________.

    a. Diversification alliance b. Shared supply alliance

    c. Complementary alliance d. Vertical integration alliance

11. An optimal business partner in a successful international strategic alliance should have two key qualities _________.

    a. Corporate culture fit and national culture fit

    b. Partner-related criteria and task-related criteria

    c. Cultural fit and trust

    d. strategic fit and cultural fit

12. The average life span for a strategic alliance is about ________.

    a. 10 years b. 3 years c. 7 years d. 5 years

13. The following reasons are good motives for mergers except ________.

    a. Economies of scale b. Complementary resources

    c. Diversification d. Eliminating Inefficiencies

14. The following are good reasons for mergers: _______=-

    a. Surplus funds

    b. Eliminating inefficiencies

    c. Complementary resources

    d. Increasing earnings per share (EPS)

15. _______ is a process of bringing two spreading signals into coarse alignment with one another.

    a. Acquisition b. Contract manufacturing

    c. Outsourcing d. Alliance

Answer Key: 1-a, 2-c, 3-c, 4-d, 5-c, 6-c, 7-a, 8-c, 9-c, 10-d

11- d, 12-c, 13-c , 14-c, 15-a

(B) State whether the following statements are True or False.

1. A merger occurs when two separate entities combine forces to create a new, joint organization.

2. Unlike mergers, acquisitions do not result in the formation of a new company.

3. Acquisition value is the seller's perceptions of the relative worth of a product or service to them.

4. Acquisitions are closely related to mergers and takeovers.

5. Mergers generally occur between companies that are roughly different in terms of their basic characteristics—size, number of customers, the scale of operations, and so on.

6. A joint venture (JV) is a business arrangement in which two or more parties agree to pool their resources for the purpose of accomplishing a specific task.

7. The first thing a successful joint venture needs is shared objectives between the two parties.

8. The co-ventures in a joint venture have equal rights.

9. Modes of entry into an international market are the channels which your organization employs to gain entry to a new international market.

10. Export can increase the sales volume.

11. In franchising, the franchisor has to pay a fee or a fraction of profit to the franchisor.

12. Wholly Owned Subsidiary is a company whose common stock is fully owned by another company.

13. Market entry strategies are methods companies use to plan, distribute and deliver goods to international markets.

14. Greenfield investments are complex market entry strategies that some companies choose to use.

15. The term "turnkey" refers to the idea that the client can simply turn a key in a lock and enter a fully operational facility.

Answer Key- True- 1, 2, 4, 6, 7, 8, 9, 10, 12, 13, 14, 15

False- 3, 5, 11

(C) Descriptive Questions

1. Explain the different modes of entries into international business.

2. What do you mean by Strategic alliance? Explain its types

3. What do you understand from the term strategic alliances? Bring out its advantages and disadvantages.

4. Explain the benefits and challenges of Joint Venture.

5. Discuss the different types of Mergers and acquisition in international business.

6. What are the reasons for merger and acquisition in international business?

4.8 REFRENCES

Charles W.L. Hill, International Business Competing in the Global Marketplace,

4th Edition, Tata McGraw Hill, Publishing Company Limited.

Cherunillam Francis, International Business, Text and Cases, 3rd Edition,

Prentice-Hall of India Private Limited.

M. Kapagam, Environmental Economics.

Philip R. Cateora, International Marketing.

Francis Cherunillam, Global Business Environment.

❄❄❄❄❄❄❄

5

INVESTMENT DECISIONS

Unit Structure

5.0 OBJECTIVES

- To study about Investment Decisions and understand the process of Investment Decisions.
- To understand about the factors affecting investment decisions.
- To understand about the Drivers of FDI
- To study about Offshore Banking
- To study about the Forex management

5.1 INTRODUCTION

Investment Decisions

Investment decision refers to financial resource allocation. Investors opt for the most suitable assets or investment opportunities based on risk profiles, investment objectives, and return expectations.

Firms have limited financial resources; therefore, the top-level management undertakes capital budgeting and fund allocation into long-term assets. Managers overseeing business operations opt for short-term investments to ensure liquidity and working capital. Investment decisions are also influenced by the frequency of returns, associated risks, maturity periods, tax benefits, volatility, and inflation rates.

Investment decisions are made to reap maximum returns by allocating the right financial resource to the right opportunity. These decisions are taken considering two important financial management parameters—risks and returns.

Investors and managers dedicate a lot of time to investment planning—these decisions involve massive funds and can be irreversible—impact on the investors and business is long-term.

Also, individuals and corporate investors have to decide between various options—assets, securities, **bonds**, **debentures**, gold, **real estate**, etc. For businesses, investments could be in the form of new ventures, projects, **mergers**, or **acquisitions** as well.

Investment decisions are further classified into short-term and long-term. For example, the final decision may involve a **capital expenditure** on assets that pay off in the long run or an investment in inventory that converts into sales within a short period. A company might attempt expansion by taking up new projects; a business might increase the capacity of an existing facility. Capital investment is required for replacing an obsolete asset as well. In business, decision-making is everywhere.

5.1.1 Process of Investment decision

Investing in an asset, security, or project requires a lot of patience; ideally, the decision-making process should be analytical. Following is a five-step process decision-making process that guides investors:

1. **Analyse Financial Position: -** For financial management, one has to understand the company or individual's current financial condition.

2. **Define Investment Objective: -** Then, investors must set up an investment objective—whether to invest short-term or long-term. They should also be aware of their **risk appetite** (level of risk they desire to take).

3. **Asset Allocation:** Based on the objective, investors must **allocate assets** into stocks, debentures, bonds, **real estate**, options, and **commodities**.

4. **Select Investment Products:** After narrowing down on a particular **asset class**, investors must further select a particular asset or security. Alternatively, this could be a basket of assets that fit the requirements.

5. **Monitor and Due Diligence: Portfolio managers** keep an eye on the performance of each investment and monitor the returns. In case of poor performance, they must take prompt action.

5.1.2 Factors Affecting Investment Decision

An investment is a planned decision, and some of the factors that are responsible for these decisions are as follows:

- **Investment Objective:** The purpose behind an investment determines the short-term or long-term fund allocation. It is the starting point of the decision-making process.

- **Return on Investment:** Managers prioritize positive returns—they try to employ limited funds in a profitable asset or security.

- **Return Frequency:** The number of periodic returns an investment offer is crucial. Financial management is based on financial needs; investors choose between investments that yield monthly, quarterly, semi-annual, or **annual returns**.

- **Risk Involved:** An investment may possess high, medium, or low risk, and the risk appetite of every investor and company is different. Therefore, every investment requires a **risk analysis**.

- **Investment Objective:** The purpose behind an investment determines the short-term or long-term fund allocation. It is the starting point of the decision-making process.

- **Return on Investment:** Managers prioritize positive returns—they try to employ limited funds in a profitable asset or security.

- **Return Frequency:** The number of periodic returns an investment offer is crucial. Financial management is based on financial needs; investors choose between investments that yield monthly, quarterly, semi-annual, or **annual returns**.

- **Risk Involved:** An investment may possess high, medium, or low risk, and the risk appetite of every investor and company is different. Therefore, every investment requires a **risk analysis**.

- **Maturity Period or Investment Tenure: Investments** pay off when funds are blocked for a certain period. Thus, investor decisions are influenced by the maturity period and **payback period**.

- **Tax Benefit: Tax liability** associated with a particular asset or security is another crucial deciding factor. Investors tend to avoid investment opportunities that are taxed heavily.

- **Safety:** An asset or security offered by a company that adheres to regulatory frameworks and has a transparent financial disclosure is considered safe. Government-backed assets are considered the most secure.

- **Volatility:** Market fluctuations significantly affect investment returns and, therefore, cannot be overlooked.

- **Liquidity:** Investors are often worried about their **emergency funds**—the provision to withdraw money before maturity. Hence, investors look at the degree of liquidity offered by a particular asset or security; they specifically consider withdrawal restrictions and penalties.

- **Inflation Rate:** In financial management, investors look for investment opportunities where returns surpass the nation's inflation rate.

5.2 DRIVERS OF FDI

5.2.1 INTRODUCTION

The most important determinants of FDI are the real estate market, market liquidity, market maturity and transparency, and institutional real estate market size Other drivers to FDI include economic and demographic factors, institutional factors, infrastructure quality, and sociocultural factors in real estate.

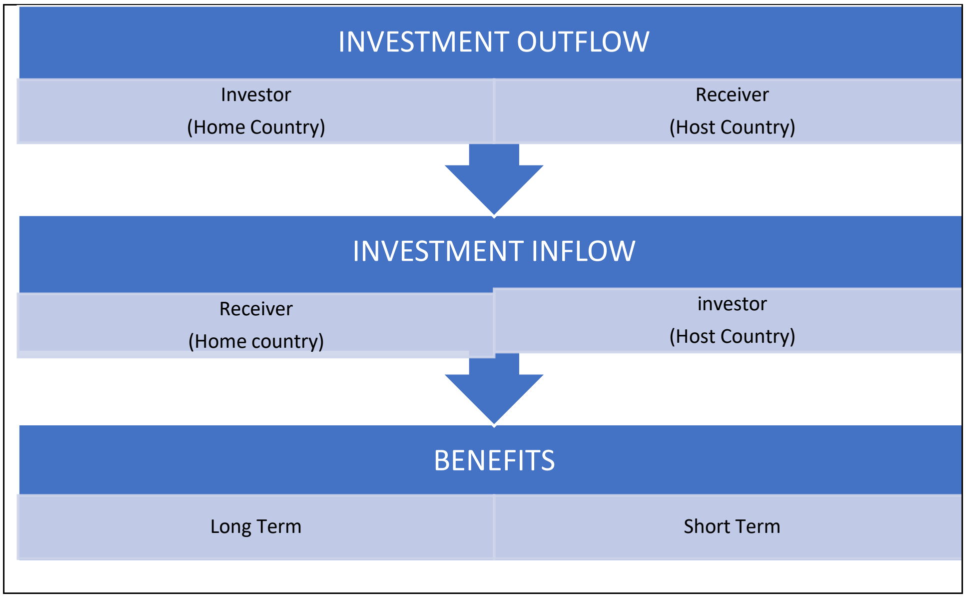
The major shifts in the policies related to Foreign Direct Investment (FDI) were initiated in India with the beginning of liberalization process in early 1990s. India has witnessed marked increase in FDI during 1990s in comparison to earlier period's. This period also corresponds to huge growth in the FDI flows worldwide. Indian performance in isolation might appear impressive but as compared to the performance of other emerging markets, India managed to attract only a paltry share in the total worldwide FDI. This chapter analyses the performance of India in attracting FDI in isolation and in comparison with other emerging markets. It examines the factors that influence the FDI in any economy.

FDI is defined as a cross-border investment in which a resident in one economy (the direct investor) acquires a lasting interest in an enterprise in another economy (the direct investment enterprise). The lasting interest implies a long-term relationship between the direct investor and the direct investment enterprise and usually gives the direct investor an effective voice, or the potential for an effective voice, in the management of the direct investment enterprise. By convention, a direct investment is established when the direct investor has acquired 10 percent or more of the ordinary shares or voting power of an enterprise abroad.

5.2.2 CHARACTERISTICS OF FDI

FDI is an activity which an investor, who is a resident in one country, obtains a lasting interest in, and is significant influence on, the management of an entity in another country. This may involve either creating an entirely new enterprise, a so-called "Greenfield" investment, or more typically, changing the ownership of existing enterprises via mergers and acquisitions. Other types of financial transactions between related enterprises, such as reinvesting the earnings of the FDI enterprises or other capital transfers, are also defined as foreign direct investment.

INVESTMENT PATTERNS



PATTERNS OF FDI

POLITICAL RISKS AND ECONOMIC RISKS

The American Motor Company (AMC) invested in the Shanghai Motor Company in China. All others, including Japanese and South Korean companies besides other American Companies made a beeline for investing in china.

5.2.3 FDI Trends in Emerging Market Countries (EMCs)

An emerging market economy is the economy of a developing nation that is becoming more engaged with global markets as it grows. Countries classified as emerging market economies are those with some, but not all, of the characteristics of a developed market.

Characteristics of developed markets may include strong economic growth, high per capita income, liquid equity and debt markets, accessibility by foreign investors, and a dependable regulatory system.

As an emerging market economy develops, it typically becomes more integrated with the global economy. That means it can have increased liquidity in local debt and equity markets, increased trade volume and foreign direct investment. It can develop modern financial and regulatory institutions. Currently, some notable emerging market economies include India, Mexico, Russia, Pakistan, Saudi Arabia, China, and Brazil.

Critically, an emerging market economy is transitioning from a low income, less developed, often pre-industrial economy towards a modern, industrial economy with a higher standard of living.

5.3 OFFSHORE BANKING

An **offshore bank** is a bank regulated under international banking license (often called offshore license), which usually prohibits the bank from establishing any business activities in the jurisdiction of establishment. Due to less regulation and transparency, accounts with offshore banks were often used to hide undeclared income. Since the 1980s, jurisdictions that provide financial services to non-residents on a big scale can be referred to as offshore financial centres. OFCs often also levy little or no corporation tax and/or personal income and high direct taxes such as duty, making the cost of living high.

With worldwide increasing measures on CFT (combatting the financing of terrorism) and AML (anti-money laundering) compliance, the offshore banking sector in most jurisdictions was subject to changing regulations. Since 2002 the Financial Action Task Force issues the so-called FATF blacklist of "Non-Cooperative Countries or Territories" (NCCTs), which it perceived to be non-cooperative in the global fight against money laundering and terrorist financing.

An account held in a foreign offshore bank is often described as an **offshore account**. Typically, an individual or company will maintain an offshore account for the financial and legal advantages it provides, including but not limited to:

- Strong privacy, including bank secrecy.
- Little or no corporate taxation via tax havens.
- Protection against local, political, or financial instability.

Offshore banking has previously been associated with the underground economy and organized crime, tax evasion and money laundering; however, legally, offshore banking does not prevent assets from being subject to personal income tax on interest. Except for certain people who meet fairly complex requirements (such as perpetual travellers), the personal income tax laws of many countries (e.g., France, and the United States) make no distinction between interest earned in local banks and that earned abroad. Persons subject to US income tax, for example, are required to declare, on penalty of perjury, any foreign bank accounts—which may or may not be numbered bank accounts—they may have. Offshore banks are now required to report income to many other tax authorities, although Switzerland and certain other jurisdictions retain bank secrecy regimes that can be more difficult to deal with. This does not make the non-declaration of the income by the taxpayer or the evasion of the tax on that income legal and many OFCs have recently been important colleagues to onshore tax authorities and law enforcement against wrongdoers. Following the 9/11 attacks, there have been many calls to increase regulation on international finance, in particular concerning offshore banks, OFCs, crypto currency and clearing houses such as Clear stream, based in Luxembourg, which are possible crossroads for major illegal money flows. Most criminality involving the banking system has happened because of the regulations and controls being circumvented.

5.3.1 Scope of offshore banking

Offshore banking constitutes a sizable portion of the international financial system. Some experts believe that as much as half the world's capital flows through offshore centres. OFCs are said to have 1.2% of the world's population and hold 26% of the world's wealth, including 31% of the net profits of United States multinationals. A group of activists state that £13-20 trillion is held in offshore accounts yet the real figure could be much higher when taking into account Chinese, Russian and US deployment of capital internationally .[10] These often regurgitated figures have not stood up to scrutiny however, and nor has the black hole theory that capital is hoarded away from the financial and tax systems in OFCs. Much like a criminal using a wallet identified and seized as proceeds of crime, it would be counterintuitive for anyone to hold assets unused. Moreover, much of the capital flowing through vehicles in the OFCs is aggregated investment capital from pension funds, institutional and private investors which has to be deployed in industry around the World.

Trillions in deposits and securities are held in offshore banks, mostly by international business companies (IBCs) and trusts. Among offshore banks, Swiss banks hold an estimated 35% of the world's private and institutional funds (or 3 trillion Swiss francs), and the Cayman Islands (over 2 trillion US dollars in deposits) are the fifth largest banking centre globally in terms of deposits. However, data by the Swiss National Bank show that the assets held by foreign persons in Swiss bank accounts declined by 28.1% between January 2008 and November 2009.

5.3.2 Advantages and Disadvantages of Offshore Banking

Advantages of Offshore Banking

- Offshore banks can sometimes provide access to politically and economically stable jurisdictions. This will be advantageous for residents in areas with a risk of political turmoil who fear their assets may be frozen, seized, or disappear.

- Some offshore banks may operate with a lower cost base and provide higher interest rates than the legal rate in the home country due to lower overheads and a lack of government intervention.

- Offshore banks generally pay interest without tax being deducted. This is an advantage to individuals who do not pay tax on worldwide income or do not pay tax until the tax return is agreed upon or feel that they can illegally evade tax by hiding the interest income.

- Some offshore banks offer banking services that domestic banks may not offer, such as anonymous bank accounts, higher or lower rate loans based on risk, and investment opportunities not available elsewhere.

Disadvantages of Offshore Banking

- Offshore bank accounts are sometimes less financially secure. In a banking crisis that swept the world in 2008, some savers lost funds that were not insured by the country in which they were deposited. Those who had deposited with the same banks onshore received all of their money back. Thus, banking offshore is historically riskier than banking onshore.

- Offshore banking has been associated in the past with the underground economy and organized crime through money laundering. Following September 11, 2001, offshore banks and tax havens, along with clearinghouses, have been accused of helping various organized crime gangs, terrorist groups, and other state or non-state actors. However, offshore banking is a legitimate financial exercise undertaken by many expatriate and international workers.

- Offshore jurisdictions are often remote and costly to visit, so physical access and access to information can be difficult.

5.3.3 Offshore Financial canters and implications for India

A synthesis of the role and evolution of OFCs in select countries, their operative mechanisms, regulatory frameworks, and privileges delineated in the preceding sections highlights various factors that contribute to the attractiveness of OFCs. Certain common facilities/exemption/concessions have been worked out to form offshore banking in India.

With the government having announced the policy of promoting Special Economic Zones (SEZs) that would, inter alia, serve to attract world class investors, and at the same time contribution towards the country's export efforts, it is pertinent to take into account the factors highlighted above that have contributed to successful OFCs around the world. This is very important, as it is necessary to create a policy environment relating to finance and banking that is conducive as well as internationally competitive. The main requirements of such a policy are provided below.

- Conducive fiscal regime, such as minimal taxation or low tax jurisdiction with an extensive web of bilateral tax treaties: no income tax, capital gains, or wealth taxes on individual, stamp duty, customs duty, estate tax, or inheritance tax.

- No withholding of income tax on non-resident depositors in OFCs.
- Stringent banking secrecy rules.
- Absence of exchange control or minimal control.
- Exemption from several prudential regulations, including reserve requirements, limitations on investments, and limitations on acquisitions of immoveable property.
- Minimum formalities for incorporation.
- Adequate legal framework that safeguards the integrity of principal agent relations.
- Conducive regulatory framework- a separate banking act to provide a regulatory framework covering the operations of banks and financial institutions in the SEZs. For instance, the offshore banking license for setting up of a branch or subsidiary.

5.3.4 Offshore banking in India an emerging sector

The concepts and practices are not new to Indian banks. Indian public sector banks such as the Bank of India, the State Bank of India, the Punjab National Bank, and the Bank of Baroda already have operations in their countries. They have developed systems and experience to handle Offshore operations. The customers in both the investing and borrowing segments are also aware of the mechanism. But in real terms, the awareness has been created while news items started appearing on overseas banking units (OBU). Offshore banking operations could be set up in Special Economic Zones(SEZ) without mandatory requirements of SLR (statutory Liquidity Ratio).

5.4. FOREX MANAGEMENT

5.4.1 INTRODUCTION

Foreign exchange, or forex, is essential to transacting global business. Consumers must convert domestic currency to make overseas purchases, while businesses are concerned with trading international profits for domestic banknotes. Global commerce, however, does carry distinct risks of losses. Effective forex management minimizes these economic risks, while providing cash flow to meet everyday expenses and improve earnings

The **Foreign Exchange Management Act, 1999** (**FEMA**), is an Act of the Parliament of India "to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India".[1] It was passed on 29 December 1999 in parliament, replacing the Foreign Exchange Regulation Act (FERA). This act makes offences related to foreign exchange civil offenses. It extends to the whole of India,[2] replacing FERA, which had become incompatible with the pro-liberalization policies of the Government of India. It enabled a new foreign exchange management regime consistent with the emerging framework of the World Trade Organization (WTO). It also paved the way for the introduction of the Prevention of Money Laundering Act, 2002, which came into effect from 1 July 2005.

Depository Receipts are – Basically negotiable instruments denominated in U.S. dollars. Whereby an Issuer or a non-U. S Indian company tap the global equity market to raise foreign fund thru its public listing and trading it in local currency equity shares in form of "Depository Receipts"

These Depository Receipts may be traded freely on an exchange or an over-the-counter market.

Depository Receipts can be either "GDRs" which are usually listed on a European stock exchange, or American Depository Receipts ("ADRs"), listed on the US stock exchange.

5.4.2 American Depository Receipts (ADR)

Devised in the late 1920s to help Americans invest in overseas securities. The main reason for introducing ADRs were the complexities involved in buying shares in foreign countries and the difficulties associated with trading at different prices and currency values.

American Depository Receipts (ADRs) are a way of trading non-U.S. stocks on the U.S. exchange. Through ADRs, Indian companies who are willing to raise funds from the U.S. can do so by issuing shares on the American Stock exchange.

However, the issuance of ADR is governed by the rules and regulations as laid down by the regulator SEC (Securities and Exchange Commission). The Indian Companies will have to maintain accounts as per the American Standards.

The Indian companies cannot directly list their equity shares on the international stock exchange. So in order to overcome this problem; the companies give shares to an American bank. These American banks in return for those shares provide receipts to the Indian companies. The companies raise funds by providing those ADR receipts in the American share market.

One ADR comprises a certain number of shares in an Indian company and these ADRs are quoted in US dollars. The investors of a foreign country can buy and sell shares directly and the investor is free to convert the ADR to receive the equivalent number of shares.

All ADRs are categorized into two broad categories –

1. Sponsored ADRs

A sponsored ADR is created through an agreement between a non-American company and an American bank.

Here, the company handles all the costs related to the issuing of the receipts in the American markets.

In return, the American bank handles all transactions between the company and the American investors through depository receipts.

These ADRs, like normal company shares, offer voting rights to their holders.

2. **Unsponsored ADRs**

These ADRs are created by American banks without the involvement or the permission of a non-American company.

Because of this, different banks can issue unsponsored ADRs for the same company as well.

However, since they don't involve the company's participation, they are usually traded over-the-counter or OTC.

They also don't offer voting rights to their shareholders.

These ADRs are further categorized into three more types –

- **Type I ADR:** These are only to establish a presence in the American market. They don't permit the raising of funds.
- **Type II ADR:** These cannot be used to raise funds, but they are permitted to have a higher visibility and trading volume than Type I ADRs.
- **Type III ADR:** These are a prestigious category of ADRs. The companies issuing these are allowed to raise funds and float an IPO on the American stock markets as well.

5.4.3 Global Depository Receipts (GDR)

A global depositary receipt is a type of bank certificate that represents shares of stock in an international company. The shares underlying the GDR remain on deposit with a depositary bank or custodial institution.

While shares of an international company trade as domestic shares in the country where the company is located, global investors located elsewhere can invest in those shares through GDRs.

Using GDRs, companies can raise capital from investors in countries around the world. For those investors, the GDRs will be denominated in their home country currencies. Since GDRs are negotiable certificates, they trade in multiple markets and can provide arbitrage opportunities to investors.

GDRs are generally referred to as European Depositary Receipts, or EDRs, when European investors wish to trade locally the shares of companies located outside of Europe.

Example of a Global Depositary Receipt

A U.S.-based company that wants its stock to be listed on the London and Hong Kong Stock Exchanges can accomplish this via a GDR. The U.S.-based company enters into a depositary receipt agreement with the respective foreign depositary banks. In turn, these banks package and issue shares to their respective stock exchanges. These activities follow the regulatory compliance regulations for both of the countries

Main features of GDR:

- GDR represents certain number of equity shares denominated in dollar terms
- The issuer collects the proceeds in foreign currency
- GDRs are traded on stock exchanges of Europe and USA
- And funds are raised from foreign capital market of the USA and Europe
- All shares to be issued are deposited with an intermediary called 'depository' located in the listing country
- The Depository issues a receipt against these shares
- Each receipt has a fixed number of shares usually 2 or 4
- The shares issued to the depository may be in physical possession of another
- Intermediary called 'custodian' who acts as depositor's agent.
- The equity shares registered in the name of depository are then issued in form of GDR to the investors of that foreign country
- The GDR does not appear in the books of the issuing company
- ADR or GDR holders do not have voting rights and therefore not bound by strict definition of foreign ownership
- Two-way fungibility is permitted in GDRs whereby they are freely convertible into Shares and back into GDRs without restriction to the extent of the original issue size.
- The issue of GDR is governed by international laws
- Since GDR is also denominated in rupees, hence, GDR does not carry any exchange risk as its face value is protected against the exchange risk
- GDRs are listed at Luxembourg and traded at two other stock exchanges namely,
- The OTC market in London and in the USA by private placement
- NRIs and foreign residents can buy GDR by using their regular share trading account

Advantages and Disadvantages of GDRs

Advantages

- GDRs help international companies reach a broader, more diverse audience of potential investors.
- They can potentially increase share liquidity.
- Companies can conduct an efficient and cost-effective private offering.
- Shares listed on major global exchanges can increase the status or legitimacy of an otherwise unknown foreign company.
- For investors, GDRs provide the opportunity to diversify portfolios internationally.
- GDRs are more convenient and less expensive than opening foreign brokerage accounts and purchasing stocks in foreign markets.
- Investors don't have to pay cross-border custody or safekeeping charges.
- GDRs trade, clear, and settle according to the investor's domestic process and procedures.
- U.S. holders of GDRs realize any dividends and capital gains in U.S. dollars.

Disadvantages

- GDRs may have significant administrative fees.
- Dividend payments are net of currency conversion expenses and foreign taxes.
- The depositary bank automatically withholds the amount necessary to cover expenses and foreign taxes.
- U.S. investors may need to seek a credit from the Internal Revenue Service (IRS) or a refund from the foreign government's taxing authority to avoid double taxation on capital gains realized.
- GDRs have the potential to have low liquidity, making them difficult to sell.
- In addition to liquidity risk, they can have currency risk and political risk.
- This means that the value of GDR could fluctuate according to actual events in the foreign county, such as recession, financial collapse, or political upheaval.

Procedural Requirements for a GDR/ADR

- Legal and accounting due diligence on Issuer in lines of the GAAP accounting principles accepted in the US
- Authorization by the shareholders

- Application for listing the additional shares on the Indian Stock Exchange
- Filing
- Facilitate and arrange Legal and Accounting Due Diligence on the Issuer
- Approval of the Foreign Investment Promotion Board ('FIPB')

Like ADR and GDR there are "Other depository receipts" depending on the country where it's issued. Euro equity issued in European countries is called as **European Depository Receipts (EDRs) #3**

In Singapore is called as **Singapore Depository Receipts #4**

Debts raised in form of bonds from international capital complying to regulations of the respective country is called as **Euro Debt**

EU Bonds

To finance its lending programmes, the Commission issued in the past bonds with maturities of 3 to 30 years.

Bonds with benchmark maturities (3, 5, 7, 10, 15, 20, 25, 30 years) will remain the principal way for the Commission to implement its funding plan.

Under Next Generation EU, the Commission has already started to issue bonds with benchmark maturities along the maturity curve and will continue to do so, both via syndicated transactions and via auctions.

In this way, the Commission is consolidating a regular presence on all parts of the maturity curve with as liquid as possible EU-Bonds.

In addition to issuing new bonds with new maturities, the Commission is, where possible, augmenting the amount of already issued bonds (taps). By doing so, the outstanding amount of the bond is increasing, making these bonds more liquid in secondary market trading and hence more attractive to investors.

Eurobonds or **stability bonds** were proposed government bonds to be issued in euros jointly by the European Union's 19 Eurozone states. The idea was first raised by the Barroso European Commission in 2011 during the 2009–2012 European sovereign debt crisis. Eurobonds would be debt investments whereby an investor loans a certain amount of money, for a certain amount of time, with a certain interest rate, to the Eurozone bloc altogether, which then forwards the money to individual governments. The proposal was floated again in 2020 as a potential response to the impacts of the COVID-19 pandemic in Europe, leading such debt issue to be dubbed "**corona bonds**".

Eurobonds have been suggested as a way to tackle the 2009–2012 European debt crisis as the indebted states could borrow new funds at better conditions as they are supported by the rating of the non-crisis states. Because Eurobonds would allow already highly indebted states access to cheaper credit thanks to the strength of other Eurozone economies, they are controversial, and may suffer from the free rider problem. The proposal was generally favoured by indebted governments such as Portugal, Greece, and Ireland, but encountered strong opposition, notably from Germany, the Eurozone's strongest economy. The plan ultimately never moved forward in face of German and Dutch opposition; the crisis was ultimately resolved by the ECB's declaration in 2012 that it would do "whatever it takes" to stabilise the currency, rendering the Eurobond proposal moot.

5.5 CASE STUDY: OUTSOURCING INITIATIVE FOR AN OFFSHORE PRIVATE BANK

The Company

The offshore arm of a well-known global banking group, with offices in the Channel Islands, Caribbean and Mauritius.

The Business Problem

The bank had grown a very successful private wealth management business in the offshore islands, but was finding it difficult to cope with increasing business volume whilst remaining within the strict financial and manpower limits set by its parent group. The specific problem was client transactions that had to be processed to strict market deadlines. The obvious solution should have been automation, but the bespoke nature of the business coupled with a new banking platform in three years meant that the business case was not viable. The Channel Islands and Caribbean are expensive places to operate and skilled resources are very difficult to obtain. There are also complicated tax and data protection issues locating client data outside of the offshore jurisdictions.

5.6 SUMMARY

An investment decision is **a well-planned action that allocates financial resources to obtain the highest possible return**. The decision is made based on investment objectives, risk appetites, and the nature of the investor, i.e., whether they are an individual or a firm. Investments are primarily classified into short-term and long-term. Further, they are categorized into a strategic investment, capital expenditure, inventory, modernization, expansion, replacement, or new venture investments.

The investment process involves the following steps: formulating investment objectives, ascertaining the risk profile, allocating assets, and monitoring performance.

Driver of FDI and FDI Trends in Emerging Market Countries (EMCs).

Offshore Banking, Advantages and Disadvantages. Similarly, Offshore Financial canters and implications for India.

Case study on Offshore Banking.

Chapter indicates the difference between ADR-GDR- EU Bonds

5.7 QUESTIONS

(A) Fill in the blanks, with multiple options: -

a) To finance its lending programmes, the Commission issued in the past bonds with maturities of __________years.

i) **3 to 30 yrs**.

ii) 3 to 45 yrs.

iii) 3to 60 yrs.

iv) 2 to30 yrs.

b) Equity issued in European countries is called as __________

i) **European Depositary Receipts.**

ii) American depositary Receipts

iii) OFF shore Banking

iv) Global Depositary

c) _____________ represents certain number of equity shares denominated in dollar terms.

i) European Depositary Receipts.

ii) American depositary Receipts

iii) OFF shore Banking

iv) **Global Depositary Receipts**

d) A sponsored __________ is created through an agreement between a non-American company and an American bank.

i) **European Depositary Receipts.**

ii) American depositary Receipts

iii) OFF shore Banking

iv) Global Depositary Receipts

e) The _______________ is an Act of the Parliament of India.

i) Parliament management Act

ii) **Foreign Exchange Management Act, 1999 (FEMA)**

iii) Off Shore Banking

iv) Reserve Bank

f) _________ constitutes a sizable portion of the international financial system.

i) **Offshore banking**

ii) Foreign Banking

iii) Management Banking

iv) Forex banking

g) Offshore banking constitutes a sizable portion of the _____________system

i) **International financial**

ii) Foreign Exchange

iii) National Financial

iv) Reserve Bank Financial

h) ______________ refers to financial resource allocation.

i) **Investment decisions**

ii) Management decisions

iii) Financial decisions

iv) Reserve Bank decisions

i) __________ and __________ dedicate a lot of time to investment planning

i) **Investors and managers**

ii) Managers and promoters

iii) Investors and Bankers

(B) State whether the following statements are True or False and correct them, if these are false:

i) The bank had grown a very successful private wealth management business in the offshore.

ii) Bonds with benchmark maturities (2, 5, 7, 10, 15, 20, 25, 30 years) will remain the principal way for the Commission to implement its funding plan.

iii) Debts raised in form of bonds from international capital complying to regulations of the respective country is called as Euro Debt.

iv) U.S. holders of GDRs realize any dividends and capital gains in U.S. dollars.

v) The GDR appears in the books of the issuing company.

vi) These Depository Receipts may be traded freely on an exchange or an over-the-counter market.

vii) The offshore arm of a well-known global banking group, with offices in the Channel Islands, Caribbean and Mauritius.

viii) As an emerging market economy develops, it typically becomes less integrated with the global economy.

ix) Investment decisions are made to reap maximum returns by allocating the right financial resource to the right opportunity.

x) Firms have unlimited financial resources; therefore, the top-level management undertakes capital budgeting and fund allocation into long-term assets.

Answers: i) ***True,*** ii) ***False,*** iii) ***True,*** iv) ***True,*** v) ***False,*** vi) ***True,*** vii) ***True,*** viii) ***False,*** ix) ***True,*** x) ***False***

(C) Answer the following questions:

1. Explain about the drivers of FDI?
2. Discuss about the offshore Banking?
3. Explain about the Advantages and Disadvantages of Off Shore Banking?
4. Discuss about FDI Trends in Emerging Market Countries (EMCs)
5. Explain briefly about the Forex Management?
6. Write short Notes on: -
    - American Depository Receipts (ADR)
    - Global Depository Receipts (GDR)
    - Off Shore Banking.
    - EU Bonds.
    - Process of Investment decision

5.8 REFERENCES

1. International management Arvind V Pathak
2. International Business by Jason Goddard
3. International Business Charles W L – McGraw Hill
4. International Business by Alan Sitkin & Nick Bowen

❄❄❄❄❄❄❄

6

WTO REGIONAL TRADE

Unit Structure

6.0 OBJECTIVES

- **To study the objectives and Functions of WTO.**
- **To understand the Building Blocks of WTO.**
- **To understand the major agreements of WTO.**
- **To study about the implications for India.**

6.1 INTRODUCTION OF WTO

The WTO (World Trade Organization) is an international organization. It enacts the rules governing trade between countries of goods, services, agricultural and industrial goods, and intellectual property. Its aim is to reduce the obstacles to free trade in order to help producers of goods and services, exporters and importers to carry out their activities.

The WTO is above all a framework for negotiation, a place where member governments attempt to resolve the trade disagreements that exist between them. The WTO has a "judicial authority", the Dispute Settlement Body (DSB), to which countries that feel they have been wronged can complain. There is a procedure for settling conflicts between Member States. This procedure is principally based on negotiation.

The WTO is not a UN agency. Since 2001, the negotiations conducted by the WTO have been the Doha Round.

The WTO produces an annual report on world trade; the purpose is to provide a better understanding of the trends in world trade, trade policy issues, and the multilateral trade system.

The **World Trade Organization** (**WTO**) is an intergovernmental organization that regulates and facilitates international trade. Governments use the organization to establish, revise, and enforce the rules that govern international trade. It officially commenced operations on 1 January 1995, pursuant to the 1994 Marrakesh Agreement, thus replacing the General Agreement on Tariffs and Trade (GATT) that had been established in 1948. The WTO is the world's largest international economic organization, with 164 member states representing over 98% of global trade and global GDP.

The WTO facilitates trade in goods, services and intellectual property among participating countries by providing a framework for negotiating trade agreements, which usually aim to reduce or eliminate tariffs, quotas, and other restrictions; these agreements are signed by representatives of member governments and ratified by their legislatures.[11] The WTO also administers independent dispute resolution for enforcing participants' adherence to trade agreements and resolving trade-related disputes. The organization prohibits discrimination between trading partners, but provides exceptions for environmental protection, national security, and other important goals.

6.2 OBJECTIVES OF WTO

In its preamble, the agreement establishing the WTO reiterates the objectives of GATT, which are raising the standards of living and incomes, expanding production and trade, and optimal use of the world's resources. To be precise the WTO has twin objective.

- Trade liberalisation, i.e. to dismantle protection of all forms.
- Elimination of discrimination, i.e. equal treatment for producers irrespective of place of their location.

WTO has framed certain rules of the game for fair play. However, it is not concerned with the outcome. The five cardinal principles of trading system are: non-discrimination, reciprocity, enforceable commitments, transparency, and safety values.

The WTO monitors global trade. Its decisions are absolute and every member must abide by its rulings. Extra powers given to WTO are supposed to ensure that disputes are settled in harmony with international trade principles. The WTO is located in Geneva, Switzerland and is headed by the Director General, who serves a term of four years. Its staff is made up of 500 individuals of varying nationalities.

The objectives of World Trade Organisation are as follows: -

1. Promote trade flows by encouraging nations to adopt non-discriminatory and predictable trade policies.

2. Raising standard of living and incomes, promoting full employment, expanding production and trade and optimum utilisation of world's resources.
3. Introduce sustainable development, a concept which envisages that development and environment can go together.
4. Taking positive steps to ensure that developing countries, especially the least developed ones, secure a better share of growth in world trade.
5. Establish procedures for resolving trade disputes among members.
6. Enhance competitiveness among all trading partners so as to benefit consumers.
7. Improve the level of living for the global population and speed up economic development of the member nations.

Four Principles

The WTO has 145 members and makes decisions on the basis of unanimity. No country has veto power.

The four principles by which members abide are:

1. Extending trade concessions equally to all WTO members.
2. Aiming for freer global trade with lower tariffs everywhere.
3. Making trade more predictable through the use of rules.
4. Bringing about more competition by cutting subsidies.

The definition of "trade "has steadily expanded and now includes intellectual protection, investment. Trade in services and agriculture, as well as trade in manufactured goods.

In its short life, the WTO has already become the focus of intense controversy. Heralded by the richer nations as the ticket to world prosperity, to many others, it is appearing to be more of a Trojan horse in the citadel of international development.

The Benefits of the WTO

The benefits because of the WTO coming into existence are as under: -

- The system helps to promote peace.
- Disputes are handled constructively.
- Rules make life easier for all.
- Freer trade cuts cost of living.
- It provides more choice of products and qualities.
- Trade raises income.
- Trade stimulates economic growth.
- Basic principles make the system economically more efficient.

- Governments are shielded from lobbying.
- The system encourages good government.

However, the WTO has often been criticized for ignoring the plight of the developing world. It is argued that the benefits of free trade accrue mostly to the developed world. In fact, free trade has many disadvantages.

In response to this the WTO may say that free trade has been an important engine of growth for developing countries in Asia. Although there may be some short term pain, it is worth it in the long run.

Its main mission is "to ensure that trade flows as smoothly, predictably and freely as possible"

6.3 FUNCTIONS OF WTO

Promotion of growth by facilitating trade is the most important function of WTO. Other important functions include:

- It oversees the implementation, administration and operation of the covered agreements (with the exception is that it does not enforce any agreements when China came into the WTO in Dec 2001
- It provides a forum for negotiations and for settling disputes.

Additionally, it is WTO's duty to review and propagate the national trade policies and to ensure the coherence and transparency of trade policies through surveillance in global economic policy-making. Another priority of the WTO is the assistance of developing, least-developed and low-income countries in transition to adjust to WTO rules and disciplines through technical cooperation and training.

1. The WTO shall facilitate the implementation, administration, and operation and further the objectives of this Agreement and the Multilateral Trade Agreements, and shall also provide the framework for the implementation, administration, and operation of the multilateral Trade Agreements.
2. The WTO shall provide the forum for negotiations among its members concerning their multilateral trade relations in matters dealt with under the Agreement in the Annexes to this Agreement.
3. The WTO shall administer the Understanding on Rules and Procedures Governing the Settlement of Disputes.
4. The WTO shall administer a Trade Policy Review Mechanism.
5. To achieve greater coherence in global economic policymaking, the WTO shall cooperate, as appropriate, with the International Monetary Fund (IMF) and with the International Bank for Reconstruction and Development (IBRD) and its affiliated agencies.

The above five listings are the additional functions of the World Trade Organization. As globalization proceeds in today's society, the necessity of an International Organization to manage the trading systems has been of vital importance. As the trade volume increases, issues such as protectionism, trade barriers, subsidies, violation of intellectual property arise due to the differences in the trading rules of every nation. The World Trade Organization serves as the mediator between the nations when such problems arise. WTO could be referred to as the product of globalization and also as one of the most important organizations in today's globalized society.

The WTO is also a canter of economic research and analysis: regular assessments of the global trade picture in its annual publications and research reports on specific topics are produced by the organization. Finally, the WTO cooperates closely with the two other components of the Bretton Woods system, the IMF and the World Bank.

6.4 STRUCTURE OF WORLD TRADE ORGANISATION (WTO)

The structure of the WTO is dominated by its highest authority; the ministerial conference. This body is composed of representatives of all WTO members. It meets every two years and is empowered to make decisions on all matters under any of the multilateral trade agreements.

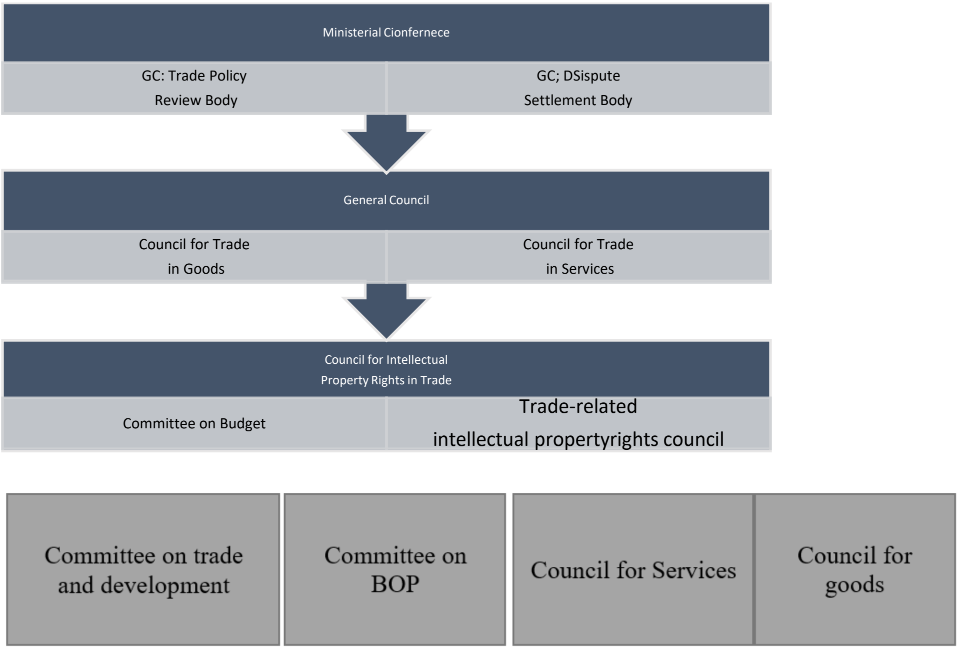
The day- to-day work of the WTO is entrusted to a number of subsidiary bodies principally, the General Council, also composed of all WTO members, which is required to report to the ministerial conference.

The General council convenes in two particular forms; as the Dispute Settlement Body and the Trade Policy Review Body. The former overseas the dispute settlement procedures and the latter conduct reviews of trade policies of individual WTO members.

The General Council delegates responsibility to three other bodies namely,

- The Councils for Trade in Goods,
- Trade in services.
- Trade- Related Aspects of Intellectual Property Rights.

The Council for Trade in Goods overseas the implementation and functioning of all the agreements covering trade in goods, though many such agreements have their own specific overseeing bodies. The latter two councils have responsibility for their respective WTO agreements and may establish their own subsidiary bodies as deemed necessary. Three other bodies are established by the Ministerial Conference who report the General council. The Committee on Trade and Development is concerned with issues relating to the developing countries and especially to the least developed countries. The Committee on balance of payments is responsible for consultations among WTO members and countries that resort to trade restrictive measures in order to cope with their balance of payments difficulties. Finally, issues relating to WTO's financing and budget are deal with by a committee on Budget, finance, and Administration.



6.5 BUILDING BLOCKS OF WTO

TRADE BLOCS

Economic Integration: - Economic integration is an agreement among countries in a geographic region to reduce or to remove, tariff and non-tariff barriers to the free flow of goods or services and factors of production among each-others; any type of arrangement in which countries agree to coordinate their trade. At the most basic level, economic integration is an agreement between countries, which aims to reduce costs for both producers and consumers. Its end goal is to remove barriers to the free flow of goods and services so that member countries can share a common market and harmonize their fiscal policies.

Trade Blocs: - A trading bloc is a type of intergovernmental agreement, often part of a regional intergovernmental organisation, where regional barriers to international trade, (tariffs and non-tariff barriers) are reduced or eliminated among the participating states, allowing them to trade with each other as easily as possible.

6.5.1 Types of Trading Blocs

1) **Free Trade Area: -** A free trade area is a group of countries that have few or no barriers to trade in the form of tariffs or quotas between each other. Free trade areas tend to increase the volume of international trade among member countries and allow them to increase their specialization in their respective comparative advantages. Free trade, also called laissez-faire, a policy by which a government does not discriminate against imports or interfere with exports by applying tariffs (to imports) or subsidies (to exports) (Ex)

A free trade area (FTA) is where there are no import tariffs or quotas on products from one country entering another. Examples of free trade areas include: EFTA: European Free Trade Association consists of Norway, Iceland, Switzerland and Liechtenstein. NAFTA: United States, Mexico and Canada (being renegotiated)

2) **Customs Union: -** A customs union is generally defined as a type of trade bloc which is composed of a free trade area with a common external tariff. Customs unions are established through trade pacts (A formal agreement between individuals or parties) where the participant countries set up common external trade policy (in some cases they use different import quotas). (Ex) The most famous example of a customs union is the European Union (EU). Trade among the member states of the EU flows tariff free, and regardless of which country in the EU imports a product, the same tariff is paid.

3) **Common Market: -** A common market is a formal agreement where a group is formed among several countries in which each member country adopts a common external tariff. Tariffs are the common element in international trading. A common market is a free trade area with relatively free movement of capital and services. The European Economic Community is sometimes referred to as the "Common Market", a regional organisation from 1958 to 1993.

4) **Economic Union: -** An economic union is a type of trade bloc which is composed of a common market with a customs union. The participant countries have both common policies on product regulation, freedom of movement of goods, services and the factors of production (capital and labour) and a common external trade policy. In addition, a common currency is used by members and this could involve a system of fixed exchange rates.

5) **Political Unions: -** Political union is the ultimate type of economic integration whereby member countries achieve not only monetary and fiscal integration but also political integration. For Example, the Europe Union (EU) is moving towards a political union similar to one created by 52 states of America.

6.5.2 Role and Importance of Trading Blocs

Trading blocs have played a positive role in the development of international trade. This can be explained with the help of following points:

1. **Economic integration:**

Trading blocs have resulted in economic integration. It represents various forms of economic integration in a region like SAARC, OPEC, ASEAN, EU etc. Trading blocs unifies different independent economies and bring the nations closer. Trading blocs helps in enhancing degree of regional co-operation and interrelationship. It brings the nation closer by unifying independent economies and facilitates economic cooperation among the members of the group.

2. **Free transfer of resources:**

Trading blocs helps in elimination of tariff, and non-tariff barriers and facilitates free transfer of resources across the border of member countries. This help in optimum utilisation of available resources. This is because no country in the world is self-sufficient and they need to depend upon one another for the fulfilment of their requirement.

3. **Increase in Trade:**

Free transfer of resources helps in increasing the productivity of member nations. They eliminate trade barriers and encourage free trade. This increase imports and export activities of member nations, which results into increase in trade revenues. Trading blocs are sound and efficient to create sustainable economic growth. Trading blocs are created to encourage trading partners to buy and sell goods already made in their home countries. It also encourages economies of scale.

4. **Employment opportunities:** Large-scale production and distribution leads to an increase in employment opportunities directly and indirectly. This results into increase in income level of the people, which enhances the standard of living of the economy.

Trading blocs tend to increase in income and employment level of the member countries. Capital is required to generate more and more employment opportunities. Trading blocs lead to free transfer of resources viz. natural, human and capital resources, which are optimally utilised for creating employment opportunities.

5. **Benefit to the consumers:**

Formation of trading blocs enables transfer of technologies across borders resulting into improvement in productivity and quality of goods and services ultimately benefiting the consumers to a greater extent.

Removal of trade barriers and free transfer of resources have resulted into mass production and distribution. This facilitates provision of quality product in competitive prices to the consumers.

6. **Cooperative spirit:**

Trading blocs leads to economic, political and cultural integration of member -countries. This develops a spirit of cooperation and coordination among member nations. This helps in maintaining good relations among the member nations.

7. **Competition:**

Trading blocs has resulted into increase in competition between companies of entire region. It also facilitates to face competition effectively. Trading blocs gives competitive advantage not only to large establish firms but also to the newly emerging firm.

8. Development of region:

Trading bloc plays an important role in contributing the development, industrialisation and economic growth of whole region. Trading blocs are a sound and efficient way to create sustainable economic growth.

Liberal policies and removal of trade barriers has resulted in the growth of industries in those regions. This in turn increased the production and distribution activities leading to economic growth of those regions.

6.6 MAJOR AGREEMENTS OF WTO

Agreements of WTO are as follows: -

1. Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)
2. Agreement on Trade-Related investment measures (TRIMs)
3. General Agreement on Trade in services.

1) Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)

The Trade related Intellectual Property Rights (TRIPs) Agreement covers the following seven categories of Intellectual property which are as follows:

- **Copyright and Related rights**: The members are required to comply with the Berne Convention for the protection of literary and artistic works. Computer Programmes are included in literary works. Authors of computer programmes and broadcasting organisations are to be given the right to authorize or prohibit the commercial rental of their works to public. This protection is extended for 50 years.

- **Trademarks:** The owner of a registered trademark has the inclusive right to prevent all third parties not having the owner's consent from using in the course of trade identical or similar signs for goods or services. Registration and renewal of a trademark is for a period of not less than seven years.

- **Geographical Indications:** Members are required to provide the legal means for interested parties to prevent the use of any indication which misleads the consumer as to the origin of goods and any use which would constitute an act of unfair competition. Additional protection is applied for geographical indications for wines and spirits.

- **Industrial Designs: -** Industrial designs are protected for a period of 10 years. Owners of protected designs would be able to prevent the manufacture, sale or importation of articles bearing or embodying a design, which is a copy of the protected design for commercial purposes.

- **Patents:** - The agreement requires members to make patents available for any inventions, whether products or processes, in all fields of technology without discrimination, subject to the tests of novelty, inventiveness and industrial applicability. There are certain exceptions to this rule. For example, members may exclude from patentability inventions contrary to order public or morality; and diagnostic, therapeutic and surgical methods for the treatment of humans or animals. It provides for 20 years.

- **Integrated circuit layout-designs** – WTO defines layout designs as the three-dimensional disposition, however expressed, of the elements, at least one of which is an active element, and of some or all of the interconnections of an integrated circuit, or such a three-dimensional disposition prepared for an integrated circuit intended for manufacture. The Trips Agreement provides protection to the layout designs of integrated circuits for a period of 10 years. But the protection shall lapse after15 of the creation of the layout design.

TRIPS agreement was revised in favor of the developing countries in 2003, as part of the Doha development agenda, when all members agreed to compulsory licensing in certain cases. However, now US and Europe remain unhappy about the current stringent terms of patent under TRIPs.

The Trade Related Intellectual Property Rights (TRIPs) Agreement refers to the control of anti-competitive practices in contractual licenses pertaining to intellectual property rights. It provides for consultations between governments in order to protect intellectual property rights from being abused. It requires a one-year transition period for developed countries to bring their legislation and practices into conformity with TRIPs.

2) Agreement on Trade-Related investment measures (TRIMs)

The Agreement on Trade-Related Investment measures (TRIMs) are rules that apply to the domestic regulations a country and to a foreign investor, as part of an industrial policy. The agreement was agreed upon by all members of the world trade organisation (WTO) The agreement, concluded in 1994, was negotiated under the WTO's predecessor, the General Agreement on Tariffs and Trade (GATT0, came into existence force in 1995.

The agreement on Trade-Related Investment Measures or "TRIMs" acknowledges that investment measures can control and twist trade.

This states World Trade Organisation members might not apply any measure that differentiates or leads to quantitative restrictions, both of which disobey any fundamental WTO rules.

A list of restricted TRIMS is a part of this agreement. The TRIMS Committee looks after the operation and execution of this agreement and allows members the chance to consult on any appropriate matters.

Agreement on TRIMs resulting from Uruguay recognises that certain investment measures may cause restrictive effects on international trade in goods.

TRIMs believe that there is a strong connection between trade and investment. The goal of trade-related investments measures is to give fair treatment to all investing members across the world.

As the TRIMs deal says, members have to inform the World Trade Organization (WTO) council to buy and sell various services and goods of their current TRIMs that are incompatible with the agreement.

Main Features of TRIMs

- It only applies to investment measures related to goods trade.
- This doesn’t apply to service trade.
- It doesn’t regulate the entry of foreign industry or investment.
- It is about the discriminatory treatment of imported/exported products.
- Concern measures were applied to both foreign and domestic firms.
- A transition period of 2 years in the case of developed countries, 5 years in the case of developing countries and 7 years in the case of LDCs, from the date this agreement came into effect, which is 1st January 1995.
- Offering equal rights to the foreign investor on par with the domestic investor.
- Phased manufacturing programming will be introduced to increase the domestic content or manufacturer.
- Granting of permission of without restrictions to import raw material and other components.

Example of Trade Related Investment measures (TRIMs)

1) Trade balancing requirements: -

   - Measures requiring that an enterprise’s purchases or use of imported products be limited to an account related to the volume or value of local products that it exports. (Violation of GATT Article)

- Measures restricting the importation by an enterprise of products used in or related to its local production, generally or to an amount related to the volume or value of local production that it exports, (Violation of GATT article XL:1).

2) Export restrictions (Domestic sales requirements)

Measures restricting the exportation or sale for export by an enterprise of products, whether specified in terms of particular products, in terms of volume or value of product, or in terms of a proportion of volume or value of its production. (Violation of GATT Article XI:1)

The Agreement on Trade Related Investment measures (TRIMs) calls for the removal at all trade related investment measures within a period of five years. These measures are confirmed to quantitative restorations and national treatment. In particular, they relate to such measures as investment in identified area, level of foreign investments for treating foreign companies at par with the national companies at par with the national companies, at par obligation, and use of local raw materials. It prevents the imposition of any performance clauses on foreign exchange, foreign equity participation, and transfer of technology. It requires foreign investment companies to be treated at par with national companies. It requires free import of raw material, components and intermediates.

3) General Agreement on Trade in services.

The GATS is a multilateral agreement under the WTO that was negotiated in the Uruguay Round and came into effect in 1995. It was essentially inspired by the same objectives as the general Agreement on Tariffs and Trade (GATT), which is its counterpart in merchandise trade which are as follows:

- Creating a credible and reliable system of international trade rules.
- Ensuring fair and equitable treatment of all participants (Principle of non-discrimination).
- Stimulating economic activity through guaranteed policy bindings.
- Promoting trade and development through progressive trade liberalization.

The GATS applies in principle to all service sectors, with two exceptions.

Article 1(3) of the GATS excludes “services supplied in the exercise of governmental authority”. These are services that are supplied neither on a commercial basis nor in competition with other suppliers. Cases in point are social security schemes and any other public service, such as health or education, which is provided at non-market conditions.

Further, the Annex on Air Transport Services exempts from coverage measures affecting air traffic rights and services directly related to the exercise of such rights.

The General Agreement on Trade in Services (GATs) distinguishes between four modes of supplying services which are cross-border trade, Consumption abroad, commercial presence and presence of natural persons.

- Services supplied from one country to another, not requiring the physical movement of the consumer (e.g. distance education, e-learning, virtual universities), also known as "Cross-border supply".
- Consumers or firms making use of a service in another country (e.g. Students who go to another country for their studies), which is called "consumption abroad".
- A foreign company setting up subsidiaries or branches to provide services in another country (e.g. twinning partnership, local branch or satellite campuses, franchising arrangements with local institutions), officially" commercial presence".
- Individuals travelling from their own country to supply services in another (e.g. professors, teachers, researchers working abroad), known a "presence of natural persons". The Annex on movement of Natural persons specifies that members remain free to operate measures regarding citizenship, residence or access to the employment market on a permanent basis.

Basic Obligation of General Agreement on Trade in Services (GATs):

Obligations contained in the GATs may be categorized into to broad groups:

- General obligations, which apply directly and automatically to all members and services sectors.
- Specific obligations, commitments concerning member's schedules

6.7 IMPLICATIONS FOR INDIA: -

After the Uruguay Round, India was one of the first governments that became member of the WTO on its first day. Different views have been expressed in support and against our country becoming a member of the WTO.

Positive impacts of the WTO on India

India is a developing country and has a vast geographical area and population. That's why it needs more capital to feed its citizens. India is good in agriculture, as its geographical condition is very good for crops, so they are self-sufficient in feeding their people and exporting edible products, but some things are imported. So, it has a perfect balance of imports and exports, and India, as one of the founding members of the WTO, has a very positive impact on it. There are some points listed below that helped in the development of India through the World Trade Organization:

- India's export competitiveness has been improved by the WTO.
- The lower tariff has helped integrate with the global economy more efficiently.
- India's growth and development have been pursued by transferring and exchanging technology and ideas.
- There is a reduction in cost and time due to market access.
- The WTO helped better settle trade disputes in a well-defined and structured manner.

Negative impacts of the WTO on India

Every positive impact carries a negative with it. Even after so many positive things, the WTO has also harmed India in some ways, which are listed below:

- The TRIPs agreement went against the Indian Patents Act (1970).
- The introduction of product patents in India by MNCs caused a hike in drug prices, which left no generic option for the poor.
- India and its research institutions have been negatively affected by the extension of intellectual property rights to agriculture.
- The MFN (most favoured nations) clause proved detrimental to India's interests and provided grounds for the Chinese invasion of the Indian market through dumping.
- India's service sectors are backward compared to those in developed countries.

Conclusion

The World Trade Organization is an international organisation that deals with the rules and regulations of trading worldwide. Currently, it has a total of 159 countries, including India. India has been the founding member of this organisation since 1995. This organisation has helped many countries to develop with the help of trade. It also helped India and still does toward making it a developed country. Trading has a significant impact on any nation's economy, and it is a part of globalisation. It also has negative impacts, but they are overshadowed by the positive impacts. So, for India, the WTO seems like a life-uplifting organisation.

6.8 SUMMARY

India and her role in various international organisations is an important topic for the civil services exam. The World Trade Organisation (WTO) is a very important intergovernmental organisation that deals with international trade and commerce.

Thus, India leads efforts to reform WTO subsidy rules to enable developing countries to engage in public food stockholding for food security purposes. It also calls for making the multilateral trading system more fair and inclusive.

WTO and its impact on Indian economy • The WTO has both favourable and non-favourable impact on Indian economy. The WTO introduced the GATS (General Agreement on Trade in Service) that proved beneficial for countries like India.

Agreements of WTO are as follows: -

1. Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)
2. Agreement on Trade-Related investment measures (TRIMs)
3. General Agreement on Trade in services.

Trade Policy Reviews are an exercise, mandated in the WTO agreements, in which member countries' trade and related policies are examined and evaluated at regular intervals. Significant developments that may have an impact on the global trading system are also monitored. All WTO members are subject to review, with the frequency of review varying according to their share of world trade.

After the Uruguay Round India, was one of the first governments that became member of the WTO on its first day. Different views have been expressed in support and against our country becoming a member of the WTO.

6.9 QUESTIONS

(A) Fill in the blanks.

i) After the Uruguay Round ______ was one of the first governments that became member of the WTO on its first day.

ii) The WTO introduced the ________________________that proved beneficial for countries like India.

iii) India has been the founding member of this organisation since________.

iv) The _______________________is an international organization.

v) The WTO monitors ______trade

vi) The WTO has _____ members and makes decisions on the basis of unanimity.

vii) The General council convenes in two particular forms; as the ________________________________

viii) A ________________ is a free trade area with relatively free movement of capital and services.

ix) The agreement _____________________acknowledges that investment measures can control and twist trade.

x) The ____________________________Agreement refers to the control of anti-competitive practices in contractual licenses pertaining to intellectual property rights.

xi) The ___agreement went against the Indian Patents Act (1970).

xii) The World Trade Organisation (WTO) is a very important ____________that deals with international trade and commerce.

(B) State whether the following statement is True or False.

a) Every positive impact carries a negative with it.

b) India is a developing country and has a vast geographical area and population.

c) India's export competitiveness has not been improved by the WTO.

d) A list of restricted TRIMS is not a part of this agreement.

e) Trading blocs leads to economic, political and cultural integration of member –countries.

f) The structure of the WTO is dominated by its highest authority; the ministerial conference.

g) The WTO is a UN agency.

h) The definition of "trade "has steadily expanded and now includes intellectual protection, investment.

i) Free transfer of resources helps in increasing the productivity of member nations.

j) All WTO members not are subject to review, with the frequency of review varying according to their share of world trade.

k) After the Uruguay Round, India was one of the first governments that became member of the WTO on its first day.

(C) Answer the following questions:

1. What is the importance of World Trade Organisation (WTO) in world trade?
2. What are the objectives and functions of World trade Organisation?
3. Explain principles of World trade Organisation?
4. Explain the Trade blocks of India?
5. Explain the various agreements of World Trade Organisation?
6. Explain the Positive and negative impact of WTO on India
7. Write short notes on: -

a) TRIMs

b) TRIPs

c) Trade Blocks

d) Implications for India.

Answers to fill in the blanks: i) India, ii) GATS (General Agreement on Trade in Service), iii) 1995, iv) WTO (World Trade Organization), v) global, vi) 145, vii) Dispute Settlement Body and the Trade Policy Review Body, viii) common market, ix) on Trade-Related Investment Measures or "TRIMs", x) Trade Related Intellectual Property Rights (TRIPs), xi) TRIPs, xii) intergovernmental organisation

Answers to True or False: a) ***True,*** b) ***True,*** c) ***False*** , d) ***False,*** e) ***True***, f) ***True***, g) ***False,*** h) **True,** i) ***True,*** j) ***False,*** k) ***True.***

6.10 REFERENCES

- International Business Rajendra P Maheshwari.
- International Business Dr. R. Chandran.
- International Business Sarup Book Publishers (P) Ltd.
- https://www.tpci.in/research_report/major-wto-agreements-implications-for-india/
- https://usiofindia.org/publication/usi-journal/world-trade-organisation-its-implications-on-indian-economy
- International Business management Venkateswaran

❄❄❄❄❄❄❄

7

MANAGING OF MULTINATIONALS (PART- I)

Unit Structure

7.0 OBJECTIVES

After going through this unit, you will be able to understand Managing of multinationals in terms of:

- Managing of multinationals

  Organization Structure
  - Matrix
  - Geographic
  - Product
- Managing of multinationals

  International HRM
  - Expatriate Management
  - Staffing of Subsidiaries
  - Integration Response Models
  - Types of subsidiaries
  - Control of subsidiaries

7.1 MANAGING OF MULTINATIONALS - ORGANIZATION STRUCTURE

Introduction

Globalization provides new opportunities to underdeveloped nations by allowing them access to new markets around the world. China and India have ridden the wave of globalization throughout the twentieth century and into the twenty-first, for example, and are rapidly becoming economic powerhouses. Even tribal groups in nations, like Brazil and Africa, can ride the wave of globalization, selling locally-made products around the world via the Internet to raise their standard of living.

(http://www.sstte.org/uploads/3/6/5/2/3652304/8119961_orig.jpg)

The multinational corporation (MNC) is playing a vital role in the globalization of world economy. MNC is a business organization whose activities are located in more than two countries and is the organizational form that defines foreign direct investment. This form consists of a country location where the firm is incorporated and of the establishment of branches or subsidiaries in foreign countries. Multinational companies can, obviously, vary in the extent of their multinational activities in terms of the number of countries in which they operate. The economic definition emphasizes the ability of owners and their managerial agents in one country to control the operations in foreign countries.

What is a Multinational Corporation?

A multinational corporation or transnational corporation (MNC/TNC) is a corporation or enterprise that manages production establishments or delivers services in at least two countries. Very large multinationals have budgets that exceed those of many countries. Multinational corporations can have a powerful influence in international relations and local economies. Multinational corporations play an important role in globalization; some argue that a new form of MNC is evolving in response to globalization: the ‘globally integrated enterprise’.

(http://lab.isit100.fe.it/~vc/20122013/ali/joomla3/images/6.jpg)

The World Book Encyclopedia defines a multinational corporation (MNC) as "a business organization that produces a product, sells a product, and provides a service in two or more countries." It is a company that manages, owns and controls production facilities in several foreign countries. An expert group of United Nations defined Multinational Corporations (MNC's) as those enterprises which own or control production or service facilities, outside the country in which they are based.

The basic characteristics of an MNC are:

(i) It operates on the basis of internationally owned assets;

(ii) It is concerned with international transfer of distinct, but complementary, factor inputs not merely equity capital, but also knowledge, entrepreneurship and sometimes goods and services of a varied kind;

(iii) Resources are transferred, but not traded in accordance with the traditional norms and practices of international trade

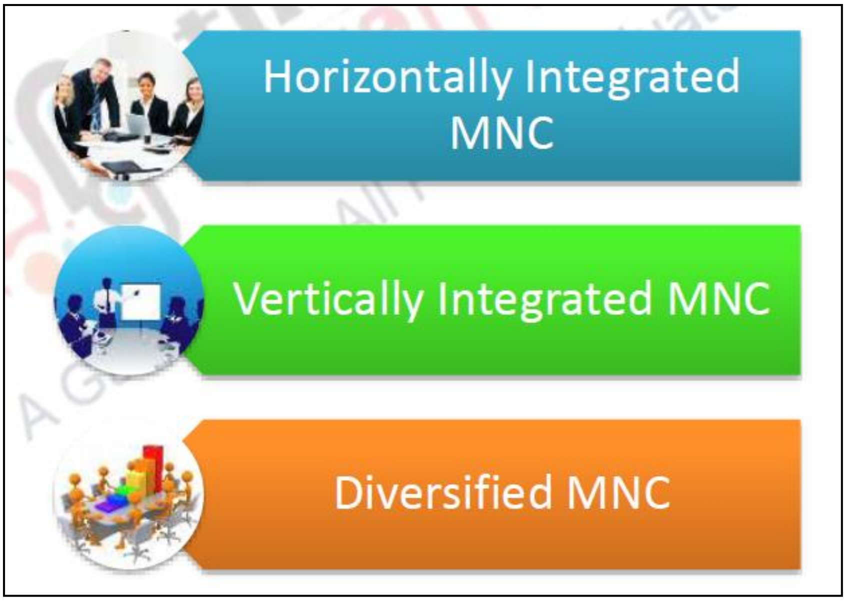
Multinational Corporation's Organization Structure

Multinational corporations can be divided into three broad groups according to the configuration of their production facilities:

- **Horizontally integrated multinational corporations** manage production establishments located in different countries to produce the same or similar products. (example: McDonalds)

- **Vertically integrated multinational corporations** manage production establishment in certain country/countries to produce products that serve as input to its production establishments in other country/countries. (example: Addidas)

- **Diversified multinational corporations** manage production establishments located in different countries that are neither horizontally nor vertically nor straight, nor non-straight integrated. (example: Microsoft)

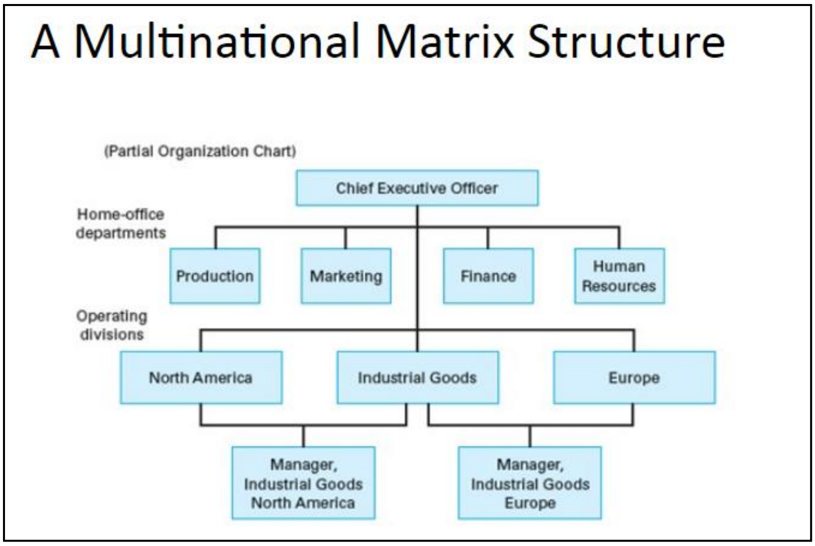


Multinational companies, especially smaller ones, face more organizational challenges than companies operating in only one national market. They have to maintain functional organizational units, but they have to fulfill these functions in different ways, depending on where the business in operating. The essential challenge is to create differentiated organizational units responsible for the foreign markets while coordinating operations across the whole company.

Matrix Structure

A matrix organizational structure combines the efficiency of the functionally organized company with the flexibility of extensive local operations. Companies work on building different pods of an organization that meet the demands of specific work needs.

Foreign workers report to local managers for questions about their work, while they report to the head office for all other functions. The home organization retains control of disciplinary matters, pay and promotions, while the employees carry out the work according to local requirements. This is a suitable organizational form for smaller companies active in only one or two foreign markets, but it is mainly used by larger corporations who have extensive foreign operations.



Geographic Structure

A geographical organizational structure organizes people within an organization by geographic location. This structure creates specific divisions for each location. Each division acts as if it is its own company, combining different types of personnel for various business functions. For example, each division may have its own marketing department, production department, sales department, distribution department and more.

Geographic organizational structures often provide local divisions with the autonomy to operate as they would like. Divisions are able to understand and respond to local preferences and demand but still follow the overall business policy. Businesses with these structures are often better able to develop efficient regional, national and international operations.

A geographical organizational structure may appeal to large entities or corporations for a variety of reasons. Large corporations may choose a geographical organizational structure to allow them to better serve the specific needs or desires of distinct groups. They may create geographic decisions based on different:

- **Cultures**
- Customer preferences
- Languages
- Rule.

Some corporations favor geographical organizational structures for logistical benefits. For example, they may choose this structure to locate facilities in areas with favorable labor costs or closer access to supplies and customers. These logistical benefits may provide companies with added financial benefits and reduce certain costs.

Advantages of Geographical Organizational Structure

Here are some advantages of the geographical organizational structure:

Better efficiency for division

Geographical organization structures combine employees from different specialties. This may help locations develop solutions and respond to clients faster. This may help with more efficient operations than at a centralized location.

Easier to coordinate

With geographical organization structures, each local division acts as its own business. All members of the business work in the same location. This makes it easier for employees to coordinate meetings with each other and meeting the challenges of the specific geographic location.

Improved focus

Working in local divisions allows employees only to focus on the objectives of their specific location. This may improve operational efficiency and overall results. Companies may enjoy increased profitability as a result.

Leadership opportunities

The local divisions of businesses with geographical organizational structures require managers with effective leadership at each location. This provides managers with the opportunity to complete on-the-job training and gain valuable experience. These leadership opportunities train managers how to lead at the top of the chain of command, preparing them for potential C-level positions within the company.

Ability to track profits

The geographic sales organization structure allows company to better track their profits based on location. Companies can track the sales performance for specific geographic locations or divisions. Also, different regions may have different profit margins, sales practices and revenues based on customer demands.

Improved customer communication

The local divisions created by geographical organizational structures often allows for improved customer communication. Local managers can maintain a regional focus, tailoring the division's operations to best fit the needs and demands of the local customers. Also, working locally often allows employees to communicate with and build and maintain relationships with customers more easily.

Flexible market response

Geographic divisions are familiar with the local conditions of the area they serve. They're able to better monitor geographic changes. Divisions have the autonomy to make decisions related to altering operations in response to changes in customer demands, needs or preferences.

Logistical efficiencies

The geographic divisional structure allows companies to organize geographically instead of centralizing. This provides each division with the autonomy regarding logistics to achieve maximum efficiency. Each division may make their own decisions based on local preferences, markets and requirements.

This includes decisions related to:

- Resources
- Shipping
- Staffing
- Salaries
- Customer data
- Supplies
- Employee hours
- Finances

Strong collaborative

Geographical organizational structures often encourage collaboration between employees. Divisions require professionals with different skills to work together to resolve issues. This structure often also encourages healthy competition between departments as a positive motivation in the workplace.

Disadvantages of geographical organizational structure

Here are some disadvantages of the geographical organizational structure:

Duplicate activities

Each division within a geographical organizational structure has their own departments. For example, each location has its own marketing department, research department, warehouse and more. This may lead to duplicate activities throughout the company. While departments at each individual location may increase efficiency at the location, it may decrease overall efficiency for the company.

More expensive

Geographic organization structures may be more expensive. These structures may use more resources, especially with duplicate infrastructures or activities within the organization. Companies with this organizational structure may sacrifice economies of scale. Production may increase, but costs may also increase.

Competition for resources

Some companies may have limited access to resource. This may make it difficult to supply each division with the resources it needs. This may cause scarcity and unhealthy competition across divisions.

Difference in employee expertise

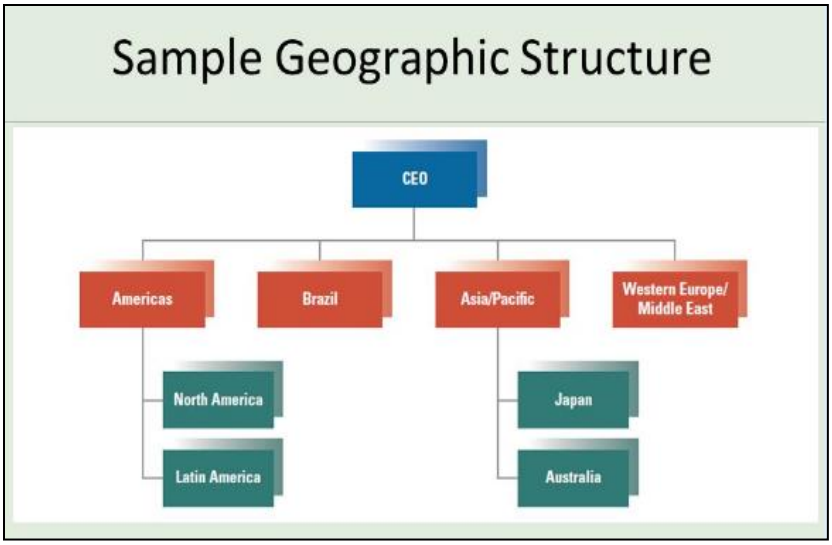
Each division employs employees with different backgrounds and expertise. These diverse teams provide their division with unique strengths and a better understanding of the local area. However, expertise will vary at different locations, possibly causing inconsistencies in the company's efforts.

Potential conflict

The divisions in companies with geographical organizational structures often have autonomy to make their own decisions. However, this decentralized approach to decision making may cause conflicts between local division management and central or corporate management at headquarters. As a result, corporate management may impose policies on the local divisions that reduce their autonomy.

Lack of company culture

Companies with geographical organizational structures may struggle to develop a cohesive company culture. There may be difficulties communicating or coordinating among different divisions. However, each division may develop its own strong company culture.



Product Structure

Product organizational structure of multinationals is a framework in which a business is organized in separate divisions, each focusing on a different product or service and functioning as an individual unit within the company.

In a product-based structure (also known as a **divisional structure**), employees are assigned into self-contained **divisions** according to:

- the particular line of products or services they produce
- the customers they deal with

- the geographical area they serve.

The structure may have several layers of managers and employees. Each layer (ie division) can have its own marketing team, its own sales team, and so on. A manager typically reports to the head of the company by product type, eg sporting goods, housewares and general merchandise. Certain key functions (eg finance or human resources) may be provided centrally.

For example, a computer software business may divide its structure according to its two distinct customer groups - home users and business users. In such an arrangement, all employees working on the development, sales or promotion of business software would be in one division, while everyone working on software for home users would be in another.

Product structure advantages and disadvantages

Product organisation may not suit everyone, but is likely to provide distinct advantages **to those** businesses that:

- have particular product lines that are substantially different
- require specialized expertise for production or distribution
- target a few major customers that make up most of your business

Product structure can also help your business:

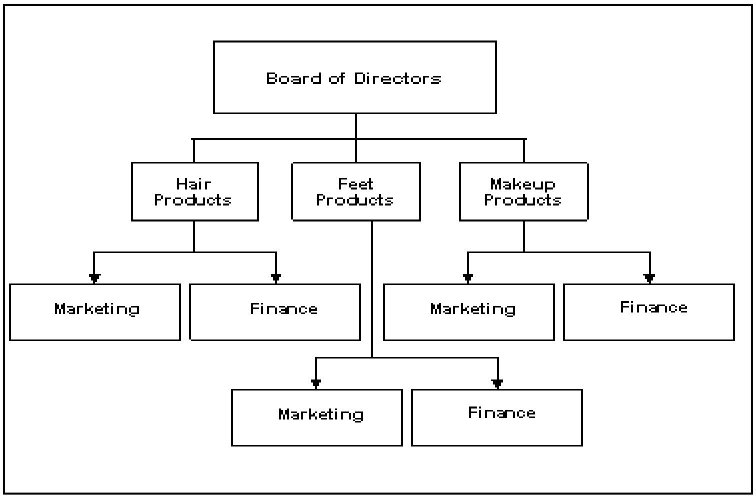
- focus on specific market segments
- meet customer needs more effectively
- extend knowledge or expertise within specialized divisions
- respond to market changes more flexibly and quickly
- encourage positive competition between each department
- coordinate and measure the performance of each division directly

Product organizational structure does have certain **disadvantages**, including being difficult to scale and potentially:

- duplicating functions and resources, eg a different sales team for each division
- dispersing technical expertise across smaller units
- nurturing negative rivalries among divisions
- over-emphasizing divisional, rather than organizational goals
- losing central control over each separate division.

Product or divisional structure is mainly suitable for larger companies with two or more key product lines, strategic customers or markets.

Global Product Division Structure



7.2 MANAGING OF MULTINATIONALS - INTERNATIONAL HRM - EXPATRIATE MANAGEMENT

The Nature of International Human Resource Management

Human resource management (HRM) is the set of activities directed at attracting, developing, and maintaining the effective workforce necessary to achieve a firm's objectives. HRM includes recruiting and selecting non-managers and managers, providing training and development, appraising performance, and providing compensation and benefits. Human resource (HR) managers, regardless of whether they work for a purely domestic firm or an international one, must develop procedures and policies for accomplishing these tasks.

International HR managers, however, face challenges beyond those confronting their counterparts in purely domestic companies, specifically, differences in cultures, levels of economic development, and legal systems among the countries in which a firm operates may force it to customize its hiring, firing, training, and compensation programs on a country-by-country basis.

Particularly troublesome problems develop when conflicts arise between the culture and laws of the home country and those of the host country, for example, prohibitions against gender discrimination in U.S., equal employment opportunity laws conflict with Saudi Arabian custom and law regarding the role, rights, and privileges of women. Such conflicts cause problems for U.S. MNCs that want to ensure their female executives receive overseas assignments equivalent to those given to their male colleagues.

The international firm also must determine where various employees should come from—the home country, the host country, or third countries. The optimal mix of employees may differ according to the location of the firm's operations. A firm is likely to hire more employees from its home country to work in production facilities there than to work in foreign facilities. Local laws also must be considered because they may limit or constrain hiring practices. For example, immigration laws may limit the number of work visas granted to foreigners, or employment regulations may mandate the hiring of local citizens as a requirement for doing business in a country.

International businesses also face more complex training and development challenges. HR managers must provide cross-cultural training for corporate executives chosen for overseas assignments. Similarly, training systems for production workers in host countries must be adjusted to reflect the education offered by local school systems. For example, because of the tradition of employment as a lifetime commitment, Toyota, like other large Japanese corporations, goes to great lengths to hire just the right people to work in its factories and offices. To help accomplish this, the firm has nurtured partnerships with local public school systems in Japan to help train and select future employees. However, Toyota cannot rely on this approach in each country in which it does business because local school systems often are not prepared to operate such training partnerships with individual firms. The German secondary school system provides extensive vocational training for its students, but that training is less firm-specific. The United States, on the other hand, emphasizes general education and provides only modest vocational training opportunities through its public schools. Moreover, many countries have labor pools that, when measured along any dimension, are uneducated and unskilled. Toyota thus has adjusted its selection, recruitment, and training practices to meet the requirements of the countries in which it does business.

Finally, because working conditions and the cost of living may vary dramatically by country, international HR managers often must tailor compensation systems to meet the needs of the host country's labor market. They must take into account variations in local laws, which may require the payment of a minimum wage or may mandate certain benefits, such as annual bonuses or health care coverage. These managers also must determine how to compensate executives on overseas assignments, which potentially face higher costs of living, reductions in the quality of their lifestyle, and unhappiness or stress as a result of separation from friends and relatives.

Strategic Significance of HRM

As with marketing, operations, and finance, the firm's managers must design an HRM strategy that promotes the company's overall corporate and business strategies. The cultural nuances inherent in international business heighten the complexities of developing an effective HR strategy. The basic elements of the international HRM process are shown in figure, which provides the framework around which this chapter is organized. The starting point is recognizing and appreciating HRM's strategic position within the firm and the interconnection between overall firm strategy and HRM strategy.

For example, suppose a firm decides to adopt a cost leadership strategy and subsequently identifies the opportunity to undercut competing firms by aggressively pricing its products in new international markets. In implementing this strategy, the firm could decide to purchase more inputs from outside suppliers, or it could shift production to a country with low-cost labor, such as Bangladesh or Vietnam. This production location decision could result in less need for home country workers and more need for workers at the foreign facility. The firm's HR managers thus would have to develop severance packages and provide outplacement services for released workers in the home country as well as select, recruit, and train the new workers in the foreign country. Over time the firm's HR managers would have to adjust their HR practices to meet the conditions in the host country, which are likely to differ from those in the home country.

The decision to shift production overseas has other HR consequences. HR managers have to select key managerial personnel to oversee the transfer of the firm's technology, operating policies, and proprietary skills to its new overseas factories. Regardless of the skills or abilities of the selected international managers, few of them will be able to walk into a foreign operation and know exactly how to do things from the first day they arrive. Thus, HR managers must provide them with training to help them function more effectively in a new culture.

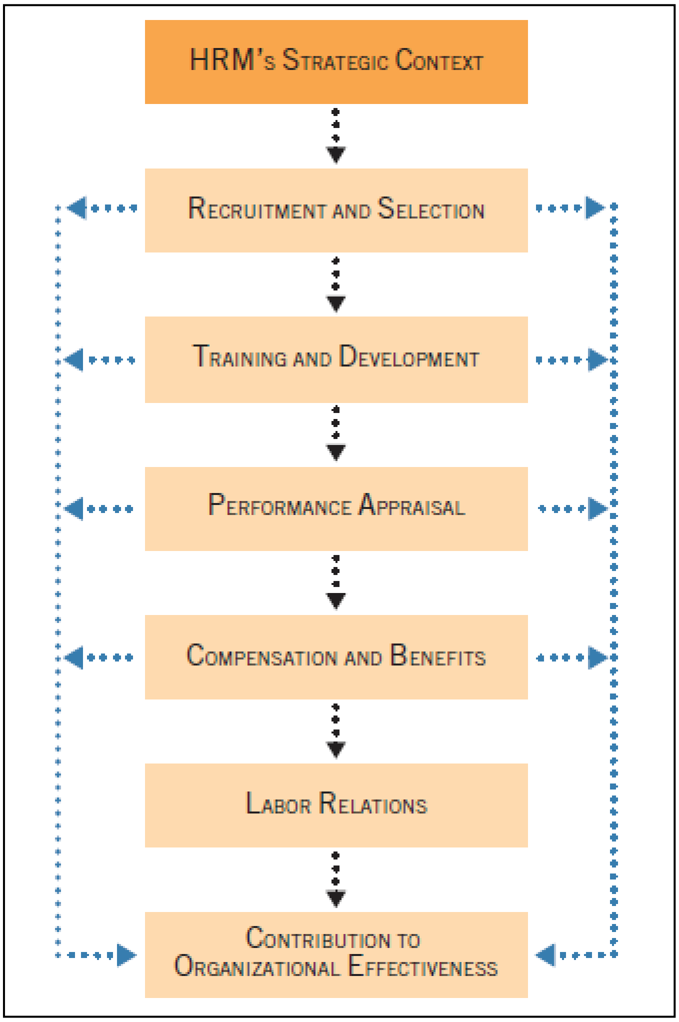
HR managers also must be prepared to define performance effectiveness and assess how well each international manager is doing relative to that definition. Moreover, international managers must be compensated for their work. Further, companies invest a lot in their international managers, so HR managers must carefully assess how effectively their firm manages retention and turnover.

In Practice:

- All international managers need to understand, at a minimum, the basic components of HRM.
- HR managers must also understand the additional complexities that exist in an International business.
- For further consideration: How might a firm's international strategy affect its HR practices, and vice versa?

Globalization is the single most significant development changing business dynamics in this century. The reality of global markets and global competition is pervasive. The forces that are driving the world towards greater globalization are greater than the forces that restrain this move. With the improvements in transportation and communication technologies there is a sea change in the way the companies are run. International trade leads to international marketing, which in turn leads to growth in international business. The phenomenal growth in international business brought about number of new concepts in international management. The old theories of international trade focused upon natural resources and crude measures of factor endowments. Newer models focus upon the actual sources of competitive advantage of companies in industries. Ultimately, competitive advantage is based upon understanding what customers need and want and on knowing how to deliver these needs and wants with a competitive advantage and in this case international human resources management becomes a critical area of study.

Figure: The International Human Resource Management Process



International Managerial Staffing Needs

The staffing issues confronting international HR managers can be divided into two broad categories.

One of these is recruiting, training, and retaining managerial and executive employees. The other is recruiting, training, and retaining non-managerial employees, such as blue-collar production workers and white-collar office staff.

For managerial employees, strategic and developmental issues are of primary importance. For non-managerial workers, differences in cultural, political, and legal conditions among countries may be of greater significance.

Scope of Internationalization

The size of the tasks of recruiting, training, and retaining managers depends on the scope of the firm's international involvement. Obviously, a firm's needs in the beginning stages of internationalization, such as in indirect exporting, are far less complex and comprehensive than those confronting an MNC with extensive investments in numerous countries. An MNC may have a number of departments. Some of these important departments are listed as under:

1. **Export department**: A firm's initial foray into international business usually involves small scale exporting using output from existing domestic production facilities. Its international activities are administered by an export department, whose manager reports to an existing company executive such as the vice president of marketing. The manager is likely to be a citizen of the home country and may or may not have special training in overseas marketing and financing. As export sales increase, however, the firm quickly recognizes it must increase its staff's expertise, so it hires specialists in export documentation, international trade financing, and overseas distribution and marketing. These specialists often are recruited from international banks, international freight forwarders, or export management companies.

2. **International division**: As its international operations grow in importance, a firm often creates a separate international division to administer all of its international activities. Typically, a firm's international division is housed at corporate headquarters in its home country and is headed by a home country citizen to facilitate communication and coordination between the domestic and international operations. The heads of the firm's foreign subsidiaries in turn report to the vice president of the international division. These foreign subsidiaries' managers (including their presidents as well as heads of functional departments such as finance, marketing, and production) may be either home country or host country citizens. Use of a home country manager facilitates communication and coordination with corporate headquarters because of shared cultural and educational backgrounds. Use of a host country manager often improves the subsidiary's ability to adjust to changes in local economic and political conditions. Cost considerations also play a major role in the choice between home country and host country managers.

3. **Global organization:** A firm further along in the internationalization process often adopts a global organization form. Because of the complexity of its operations, a global organization must assemble a team of managers that have the expertise to produce, finance, and market its products worldwide while simultaneously coordinating its activities to achieve global production, financing, and marketing economies and synergies. To operate successfully, a global firm needs

a team of managers that collectively possess expertise in and knowledge of the following:

- The firm’s product line: Product managers must be aware of such factors as the latest manufacturing techniques, research and development opportunities, and competitors’ strategies.
- The functional skills (accounting, logistics and marketing, manufacturing management, and so on) necessary to ensure global competitiveness: Functional specialists strive to capture global economies of scale and synergies in a firm’s financial, marketing, and production activities.
- The individual country markets in which the firm does business: Country managers must understand such factors as local laws, culture, competitors, distribution systems, and advertising media. These managers play a key role in meeting the needs of local customers, ensuring compliance with host country rules and regulations, and enlarging the firm’s market share and profitability in the host country.
- The firm’s global strategy: High-level executives at corporate headquarters must formulate a global strategy for the firm and then control and coordinate the activities of the firm’s product, functional, and country managers to ensure that its strategy is successfully implemented.

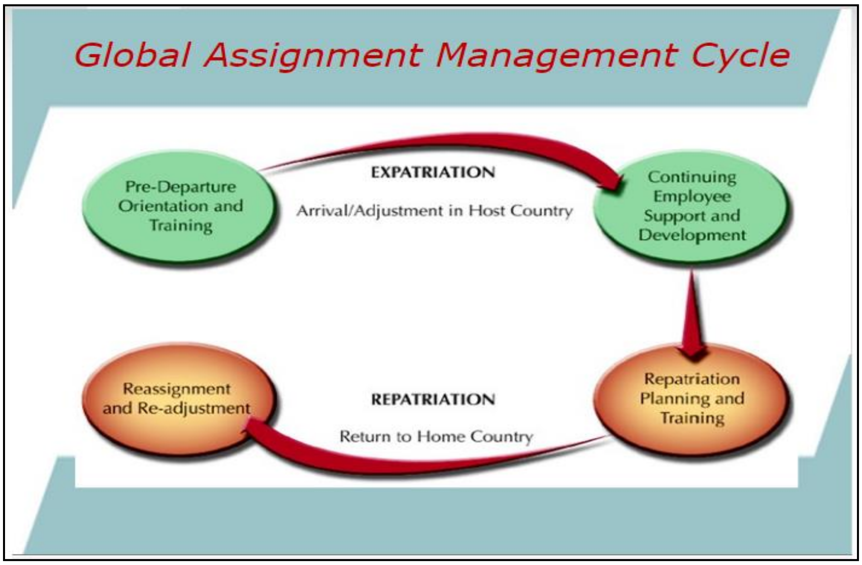
Expatriate Management

Rapid globalization and boundary less business ventures have contributed to a growing number of expatriates working in foreign locales. As a result of this, it is increasingly important that multinational corporations sending their employees for international assignments prioritize expatriate management. The Global Delivery Model followed by the Indian firms creates a number of onsite (international) opportunities for Indian professionals. The effective management of expatriates is increasingly been recognized as a major determinant of success or failure in international business.

Increasing economic globalization has spurred the expansion of multinational corporations (MNCs) and has multiplied the numbers of the human capital moving across the globe. The globalization of the markets creates a situation where organizations rely on having subsidiaries in foreign countries. For various motives they send employees, so-called expatriates, on foreign assignments. An expatriate (often shortened to expat) is a person temporarily or permanently residing, as an immigrant, in a country other than that of their citizenship. The word comes from the Latin terms ex ("out of") and patria ("country, fatherland").In common usage, the term is often used in the context of professionals or skilled workers sent abroad by their companies. An individual living in a country other than their country of citizenship, often temporarily and for work reasons is an expatriate. An expatriate can also be an individual who has relinquished citizenship in their home country to become a citizen of another country. If your employer sends you from your job in its India office to work for an extended period in its London office, once you are in London, you would be considered an expatriate or "expat." The way an organization manages its expatriates is called expatriate management.

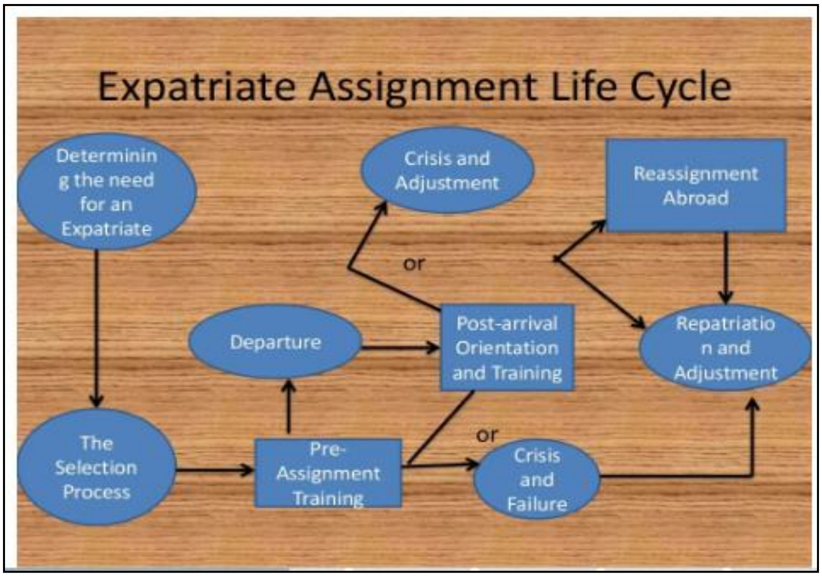
Expatriates play a crucial role for their organization and performance of a company in the international arena is largely dependent on the performance of its expatriate employees. Multiple factors have discerning impact upon expatriate assignments and organizations need to respect that simply prioritizing international business in terms of revenue would be incomplete without sound expatriate management policies. The human and financial costs of underperformance / failure in the international business area are considerably more severe than in the domestic area. Many organizations relatively new to the international scene underestimate the complex nature of human resource (HR) problems in the international arena and that business failures in the international arena may often be linked to the poor performance of expatriates.

In order to maintain and enhance their global competitiveness, the MNCs rely on finding the right people who can effectively manage and operate their overseas businesses. However, expatriate assignments are not always successful, and there is wide diversity in the failure ranges.



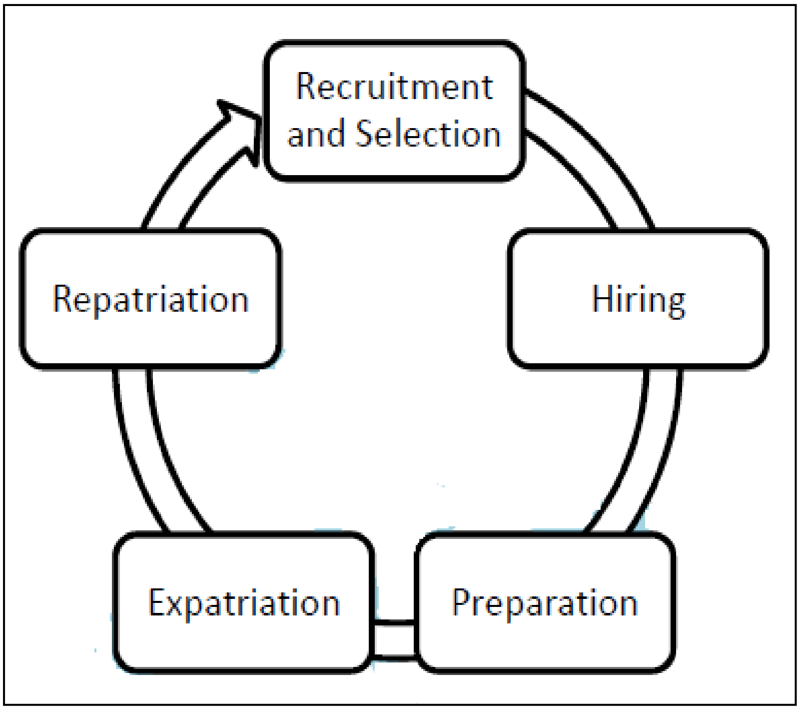
Expatriate Assignment Cycle

In order to manage international assignment cycle MNC's evaluate what should be done, which employee should be sent for international assignment, what steps should be opted…etc as elaborated below:



For successful entry and continuous growth in a foreign market, effective communication with the unfamiliar partner and adaptation to his culture is important. Globalization requires cross-cultural literacy and successful management of diversity. Though not much empirical evidence is available on the impact of cross-cultural literacy on the cost of doing business in foreign markets, it is fair to assume that cross-cultural literacy reduces the total costs of operating in foreign markets. Multinational companies (henceforth MNCs) with world-wide subsidiaries need to recognize the impact of socio-cultural values on local organizational behavior to be able to successfully transfer the know-how to various local units. Since early-1990s, a growing number of MNCs have been attracted to India and many more are planning to enter India. The basic process of selection of an expatriate and repatriation (i.e. coming back of an expatriate either by completing the task given to him or coming earlier from foreign country without completing the task) is as shown below:-

It is the MNC’s or organization who has the ability to manage their expatriates. To manage expatriates and in order to overcome the repatriation cost, MNC’s or organizations support their expatriates.



Expatriate Selection Process

The companies that manage their expats effectively come in many sizes and from a wide range of industries. Yet it has been found that they all follow three general practices:

When making international assignments, they focus on knowledge creation and global leadership development.

Many companies send people abroad to reward them, to get them out of the way, or to fill an immediate business need. At companies that manage the international assignment process well, however, people are given foreign posts for two related reasons: to generate and transfer knowledge, to develop their global leadership skills, or to do both.

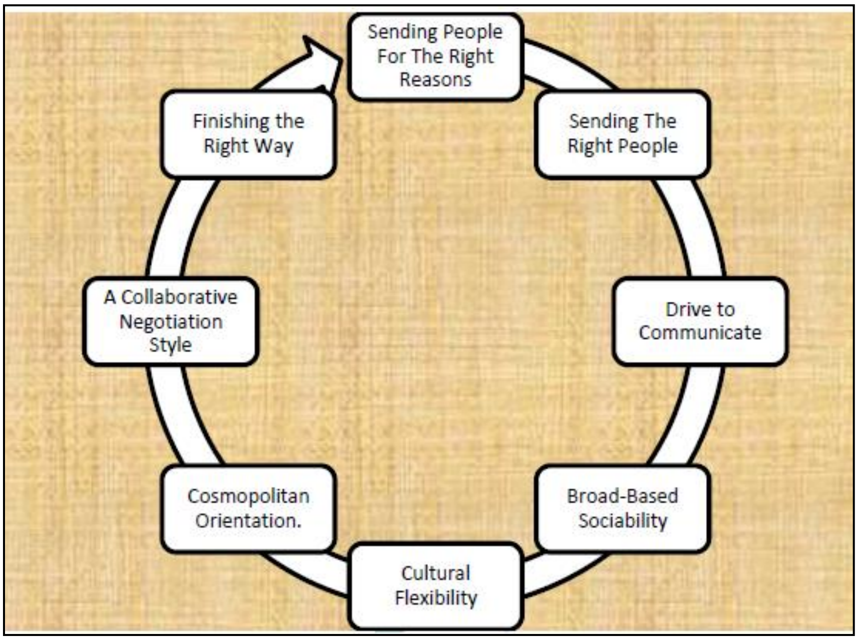
They assign overseas posts to people whose technical skills are matched or exceeded by their cross-cultural abilities.

Companies that manage expats wisely do not assume that people who have succeeded at home will repeat that success abroad. They assign international posts to individuals who not only have the necessary technical skills but also have indicated that they would be likely to live comfortably in different cultures.

They end expatriate assignments with a deliberate repatriation process.

Most executives who oversee expat employee's view their return home as a non-issue. The truth is, repatriation is a time of major upheaval, professionally and personally, for two-thirds of expats. Companies that recognize this fact help their returning people by providing them with career guidance and enabling them to put their international experience to work.

Thus based on above mentioned practices the selection process can be explained as:



Sending People for the Right Reasons: Immediate business demands cannot be ignored. But the companies that manage their expats effectively view foreign assignments with an eye on the long term. Even when people are sent abroad to extinguish fires, they are expected to plant forests when the embers are cool. They are expected to go beyond pressing problems either to generate new knowledge for the organization or to acquire skills that will help them become leaders.

Sending the Right People: Managers often send people on overseas assignments who are capable but culturally illiterate. Companies that have a strong track record with expats put a candidate's openness to new cultures on an equal footing with the person's technical know-how. After all, successfully navigating within your own business environment and culture does not guarantee that you can maneuver successfully in another one.

Drive to Communicate: Most expats try to communicate with local people in their new country, but people who end up being successful in their jobs are those that don't give up after early attempts either fail or embarrass them. To identify such people, the most effective companies scanned their ranks for employees who were both enthusiastic and extroverted in conversation, and not afraid to try out their fractured French or talk with someone who's English was weak.

Broad-Based Sociability: The tendency for many people posted overseas is to stick with a small circle of fellow expats. By contrast, successful global managers establish social ties to the local residents, from shopkeepers to government officials. There is no better source for insights into a local market and no better way to adjust to strange surroundings.

Cultural Flexibility: It is human nature to gravitate toward the familiar—that's why many Americans overseas find themselves eating lunch at McDonald's. But the expats who add the most value to their companies—by staying for the duration and being open to local market trends—are those who willingly experiment with different customs. In India, such people eat dal and chapattis for lunch; in Brazil, they follow the fortunes of the local jai alai team.

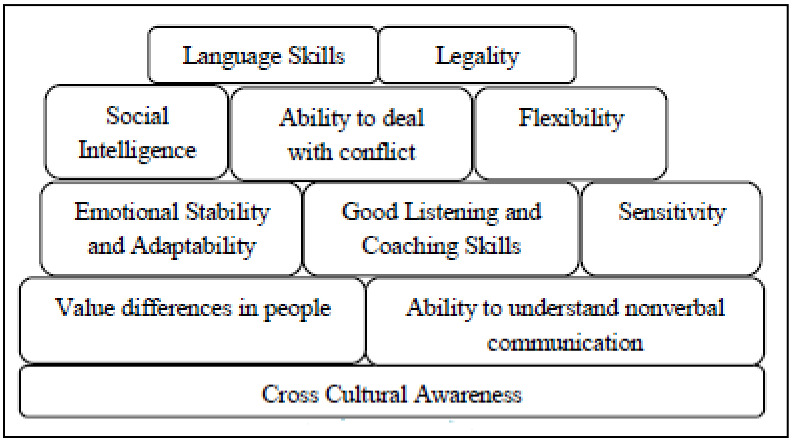
Cosmopolitan Orientation: Expats with a cosmopolitan mind-set intuitively understand that different cultural norms have value and meaning to those who practice them. Companies that send the right people abroad have identified individuals who respect diverse viewpoints; they live and let live.

A Collaborative Negotiation Style: When expats negotiate with foreigners, the potential for conflict is much higher than it is when they are dealing with compatriots. Different cultures can hold radically different expectations about the way negotiations should be conducted. Thus a collaborative negotiation style, which can be important enough in business at home, becomes absolutely critical abroad.

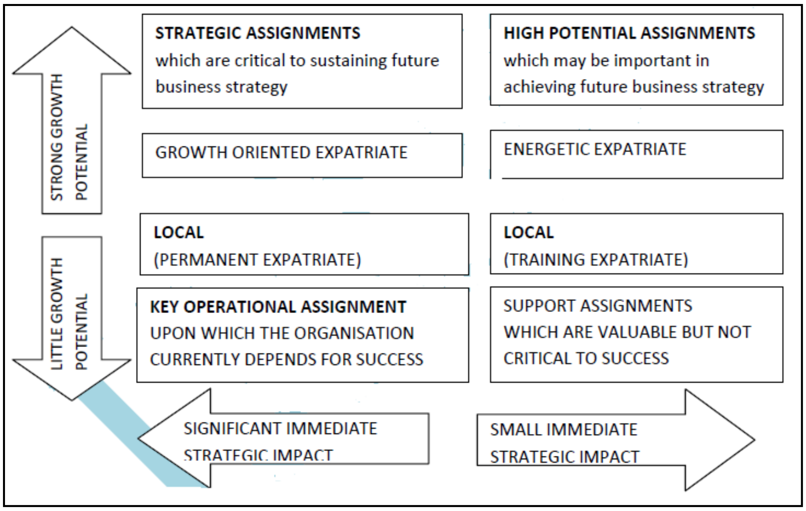
Finishing the Right Way: International assignments end badly for several reasons. First, although employers give little thought to their return, expats believe that a successful overseas assignment is an achievement that deserves recognition. They want to put their new skills and knowledge to use and are often disappointed both by the blasé attitude at headquarters toward their return and by their new jobs. That disappointment can be particularly strong for senior expats who have gotten used to the independence of running a foreign operation. As shown above in expat selection process. Executives know that negotiation tactics and marketing strategies can vary from culture to culture. Most do not believe, however, that the variance is sufficient to warrant the expense of programs designed to select or train candidates for international assignments. After evaluating all factors the employee is decided to be sent as an expatriate if he fulfills all requirements.

Types of Expatriates:- Expatriates can be classified into two:

Energetic Expatriate



Growth Oriented Expatriate



Based upon the characteristics differentiation on types of expatriates, expatriate managers can be dimensioned as:

- **The self-dimension**: The skills that enable a manager to maintain a positive self-image and psychological well-being
- **The relationship dimensions**: The skills required to foster relationships with the host-country nationals
- **The perception dimension**: Those skills that enable a manager to accurately perceive and evaluate the host environment

But working in a foreign country is not an easy task. The problems which an expatriate have to face are elaborated in the form a pictorial diagram as shown below:

Thus as shown above the Six important factors of expatriated managers are:

- **Cultural intelligence (CQ)**: ability to adapt across cultures through sensing the different cues regarding appropriate behavior across cultural settings or in multicultural settings
- **Family situation**: ability to keep in touch with families collaboratively and continuously
- **Flexibility and adaptability**: ability to fit changed circumstance
- **Job knowledge and motivation**: ability to transfer knowledge smoothly and transfer international assignment into career advancement
- **Relational skills**: ability to build up relationships more actively
- **Extra cultural openness**: ability to communicate with others more openly.

7.3 MANAGING OF MULTINATIONALS – INTERNATIONAL HRM – STAFFING OF SUBSIDIARIES

International human resource professionals play a key role in the implementation of a multinational corporation's (MNC's) strategy in the global stage. Global staffing remains a broad and difficult topic even to experienced and savvy professionals and must be tackled with prudence as human resources has become a key strategic function in the organization.

Different international staffing strategies for staffing of the subsidiaries that can be used by international human resource professionals are: ethnocentric, geocentric, polycentric, and regiocentric. The international human resource professionals can use to hire staff for their foreign subsidiaries. The process of choosing a suitable strategy for each region depends on the region's characteristics related to culture, wage rates and literacy level. Based on these characteristics managers of multinational corporations (MNCs) would do well by using a geocentric strategy in North America, an ethnocentric or regiocentric strategy in Asia, an ethnocentric strategy in Europe, a polycentric or regiocentric strategy in Latin America, a polycentric strategy in the Middle East, and, begin with a regiocentric strategy and slowly change to a polycentric strategy in Africa.

Ethnocentric staffing: With a centralized strategic dimension this strategy involves staffing the most important positions in foreign subsidiaries with expatriates. Hiring expatriates has the strategic advantage that expatriates oftentimes would best represent the interests of the home office and ensure that the foreign operations are aligned with headquarters. Most expatriates are selected from current employees in the home offices and simply transferred to the foreign subsidiaries, saving the time and effort required in hiring new employees. However, staffing exclusively with expatriates will also entail several disadvantages. First, expatriates tend to be a lot more expensive to manage than local staff due to relocation costs, relocation allowances and other related costs.

Those who work internationally instinctively expects to get higher salaries than locals. Second, expatriates may not have good knowledge of the local perspectives and insights in the local atmosphere available to local employees.

Polycentric staffing: With a local strategic dimension this strategy necessitates that a company hire host-country nationals for all positions at its foreign subsidiary–from clerks up to executives. This strategy has the advantages that local employees may not be as expensive as foreign employees and locals will be more familiar with the customs, values and culture of their national society. As expected, this strategy has the disadvantage that it can only be used in the countries with high availability of educated people to fill the key positions. Additionally, there may exist language and cultural hurdles between the host country employees and headquarters, and locals may put the local interest first.

Geocentric staffing: This staffing strategy, with a truly global strategic dimension, involves hiring the best employees for key positions globally regardless of their country/region of origin. The advantage with this strategy is that there is a high chance of getting highly qualified staff for the company. Nevertheless, this will involve dealing with a multitude of different people with different cultural backgrounds and beliefs. Also, the host-country's immigration policies may limit the implementation of this strategy or make it more costly to implement than would be for other strategies.

Regiocentric staffing: Similar to polycentric staffing, this strategy involves hiring staff within the region in which the company subsidiary is located. MNCs pursuing this strategy group company office into regions and employees can be transferred within the region but not outside of the region. In this case each region will have its own human resource practices and policies, with some degree of autonomy from headquarters.

Global Staffing Strategies and Strategic Dimensions

Staffing strategy	Ethnocentric	Polycentric	Geocentric	Regiocentric
Strategic dimension	Centralized	Local	Global	Regional
Geographic focus	Home country	Host country	Global	Regional

Factors that Affect Staffing Variations across Different Regions

Prior to deciding which staffing strategy to employ for which geographic region or country it is imperative to consider a number of factors.

Culture and Beliefs

Different regions, different countries and different ethnic groups would have different cultural backgrounds and thus different beliefs which are key factors to consider when planning an international strategy. A culture can be understood as “the collective mental programming of the people in an environment”. Though it is arguable that a culture does not apply to all members within a region, it is arguably true that certain cultural facets are common among individuals within close geographic locations. It is difficult to define what the culture of a country is, and thus affixing a culture to a nation doesn’t indicate that “all individuals belonging to the country have all the features given to the culture”. As a result, only common elements are stated when talking about national cultures. The nationals from the same country share “national character” that is obviously discernable to foreigners. A country can be classified into one or more of the following “cultural dimension”: “Power distance, Uncertainty avoidance, individualism-Collectivism, and Masculinity”.

With regional integration of national boundaries through free trade agreements these ideas will also hold true within regions. Additionally, different regions will have variations in their regional cultures and beliefs leading to variations in regional staffing strategies. In certain nations, for example, women may not be allowed (or if allow they will not feel comfortable) to work alongside men in the same offices.

Wages

Wage rates have wide variations within different regions resulting to variations in effective staffing strategies for different regions. The international Labour Organization (ILO) defines a wage as “the total gross remuneration including regular bonuses received by employees during a specified period of time for time worked as well as time not worked, such as paid annual leave and paid sick leave”. ILO reports that global wages have been increasing rapidly since 2007, though with significant regional differences. Real wage increases in 2013 stood at the following percentages in different regions: Asia-6%, Europe-0.2%, Latin America-1%, middle east-4%, Africa-1%, and North America-1%, with nearly half of wage rise globally coming from China alone. Due to the large population and the rapid growth taking place in China (and therefore Asia), China has been contributing near 50% of wage growth globally.

Europe and North America have been having the lowest average wage increases in recent years implying that wage rates in these regions are fairly stable year on year. It is not surprising, for these economies are in their advance stage of development with minimal interest rates and equally minimal inflation rates. Following Europe and North America with low annual increase in wages is the Middle East, then Africa, Latin America and Asia having the highest growth rate in annual wages–probably largely contributed by China. The wages in Europe and North America are more than triple the next highest region (Latin America), and, Asia, though with rapidly rising wage rates remains one of the regions with the lowest salaries.

Literacy

The proportion of literate people in a region would also determine which staffing strategy would work better for the region. In a region dominated with mostly illiterates it would be hard to find and successfully train staffs for key positions in the company, leading to either of polycentric and regiocentric staffing being ineffective strategies in the region. UNESCO provides estimates of the proportions of literate youths and adults in various world regions–exclusive of North America. According to the estimates global literacy rates for adults stood at 76% in 1990, 82% in 2000s, and 84% in 2011. With an analysis of each regions' culture, beliefs, literacy and wage rate, attention shifts to deciding which staffing strategy would effectively work for which region.

The wage rate in Africa is low and the diversity in cultures is huge. African cultures are and beliefs are totally unfamiliar to people from all other regions. Training managers based on other regions' theories with the aim of posting them to successfully work in these unfamiliar cultures of Africa is of no use and may even lead to more harm than good for the company–thus rolling out ethnocentric strategy in this region. This leaves either polycentric or regiocentric strategy being the best for foreign MNCs operating in African countries. On the other hand, the literacy rate for this region is very low making it hard to hire and train local employees for key management positions. Therefore foreign MNCs, at the start of operations in this region, may do better by staffing with a regional focus and then slowly switching to a polycentric strategy as time goes by.

Asian countries, though the salary rate is low, are in a period of fast pay growth, resulting to absolute uncertainty in the future staffing approach. There also exists diverse cultures in Asia, but the key cultures are being vastly studied in western literature. Therefore proper training of managers based on host-country theories would not be a bad approach. This leads to a regiocentric or ethnocentric staffing strategy being good for Asia.

European culture has been widely studied in all regions for centuries and the studies are ongoing. The literacy rate in Europe is very high making it easy to hire talented staff within the region. Nevertheless, European salary rates are exorbitantly high compared to other regions' which make a polycentric strategy not financially worthwhile for the region. Equally, Europeans seem not to show any xenophobic character toward foreign employees. This leads to ethnocentric strategy being the best for foreign companies operating in Europe.

Latin America possesses high literacy rate among youths and adults. The average wage rate in this region is not very high and the region possesses a multitude of cultures which, if not familiar to any other region's people, may not be easily learned. Therefore, a regiocentric or polycentric strategy would be more suitable for foreign company subsidiaries in Latin America.

The Middle East consists of country cultures with stringent religious beliefs. Salaries in this region are average (and growing slowly), and the literacy rate is average. Host country nationals may exhibit xenophobia towards expatriates and policies on gender inequality may not be familiar to foreigners. Thus, a polycentric strategy would be most suitable for Middle Eastern countries.

North America is in possession of a culture that is widely known and studied in all other regions. American theories are the most studied in management literature not only in America but in every other part of the world. Thus competent managers from any part of the world can do equally well in North American countries. The region has the highest wage rate of all other regions– leading to local hiring being a disadvantage. This leaves Geocentric staffing strategy as the best choice for subsidiaries of foreign companies operating in North America.

Table below summarizes the various staffing strategies for different regions.

Regional Staffing Strategies

Staffing strategy	Ethnocentric	Polycentric	Geocentric	Regiocentric
Strategic dimension	Centralized	Local	Global	Regional
Geographic focus	Home country	Host country	Global	Regional
Regions most suitable	Asia, Europe,	Africa (later), Latin America, Middle East,	North America	Africa (beginning), Asia, Latin America,

7.4 SUMMARY

A multinational corporation (MNC) is a company that has business operations in at least one country other than its home country. Generally, a multinational company has offices, factories, or other facilities in different countries around the world as well as a centralized headquarters which coordinates global management. Multinational companies can also be known as international, stateless, or transnational corporate organizations or enterprises. Some may have budgets that exceed those of small countries. The structural forms of multinational corporations can be horizontally integrated, vertically integrated and diversified, matrix, geographic and product.

Expatriate management is a concept that may include two different activities: management of expatriates and management by expatriates. The former includes all the traditional activities undertaken by organizations to manage their assigned expatriates, from recruitment to repatriation. Management by expatriates is associated with most cross-cultural and other issues that foreign managers encounter in a host location, from language problems and communication difficulties to leadership challenges.

The procurement of staff for international companies is a key strategic function for human resource professionals. In order to completely understand which strategies are suitable for employing staff for any geographic region, it is of necessity to consider that certain factors, such as wage, culture and literacy would influence the effectiveness of the strategy. Drawing from the results of these analyses, an appropriate staffing strategy can be implemented for the region and different regions can employ different strategies with the same company.

International business is dynamic. Business is crossing borders. Globalization is gaining momentum. Markets are no longer protected from foreign competition. Markets are now open for competition from both domestic and foreign firms. A large proportion of workforce is located in other countries away from their homes and home countries. For example, Ford Motor Company has half its employees outside the United States, Philips has three-fourths of its employees working outside the Netherlands and more than half of Ericsson’s workforce is located outside Sweden.

Issues of managing business are becoming more and more complex in the same pace as globalization is taking placing. The unusual level of foreign competition in both domestic and foreign markets is forcing businesses to find and retain the competitive advantage. Finding and nurturing the suitable and capable human resources in the context of high competition at both domestic and international levels is high on the list of priorities of the top managements. Quality human resources are a must for implementing global competitive strategies. Firms expanding into international markets are put under additional pressure to manage their limited resources and for such firms managing human resources is more essential than any other firm. Having right people in the right place at the right time is key to a company’s international growth.

7.5 EXERCISES

Q.1. What is a multinational corporation?

Q.2 Explain the different types of Multinational Corporation’s organization structure.

Q.3 Discuss the nature of international human resource management.

Q.4 What are the challenges faced by expatriates?

Q.5 Discuss different HRM strategies for staffing of subsidiaries.

7.6 SUGGESTED READING

a. International Business - Mike W. Peng; Klaus E. Meyer - Cengage Learning

b. International Business Environment, The: Text and Cases- J Stewart Black ; Anant K Sundaram – Prentice Hall India

c. International Business –Charles W L Hill - McGraw Hill

d. International Management - Arvind V Pathak – TMH

e. The Cultural Dimension of International Business – Gary P Ferraro – Pearson

f. Multinational Management – John B. Cullen _ Thomson

g. International Business: Challenges and Choices - Alan Sitkin, Nick Bowen – Oxford Press

❄❄❄❄❄❄❄

8

MANAGING OF MULTINATIONALS (PART- II)

Unit Structure

8.0 OBJECTIVES

After going through this unit, you will be able to understand Managing of multinationals in terms of:

Integration ResponseModels

- Types of subsidiaries
- Control of subsidiaries

Global manufacturing and supply chain

- Optimizing of Supply chain
- Offshoring V/S Outsourcing

8.1 MANAGING OF MULTINATIONALS - INTEGRATION RESPONSE MODELS

In the global integration model, management power in the multi-national corporation is primarily centralized at the MNC headquarters (HQ). MNC subsidiaries have little flexibility or autonomy. In the localization model, on the other hand, the MNC HQs do not standardize the business activities of their subsidiaries, and the subsidiaries therefore enjoy more freedom and autonomy than that in the integrated model.

MNC global integration may cover various business activities. One of these is sourcing, where MNC subsidiaries receive inputs or supplies for their operations. The more a subsidiary relies upon its parents for supplies, the more globally integrated is the subsidiary’s operations. Similarly, global integration can also be measured by the level of centralization of R&D functions, and the subsidiary’s autonomy in selling its products to local markets or through its parents’ integrated systems. Existing literature argues that global integration helps MNCs save costs and achieve global efficiencies. For example, global integration minimizes duplication, thus saving costs through standardization, and global integration creates efficiencies due to global economies of scale. MNCs achieve high efficiency through two methods. Firstly, they rely upon supplies (sourcing) from low labor cost countries. Secondly, even if MNCs do not rely upon supplies from low labor cost countries, they can still enjoy high efficiency if they centralize their operations and/or aggregate their sourcing to enjoy global economies of scale. Similarly, MNCs gain efficiency advantages from national differences in labor costs (i.e., getting supplies from low labor cost countries), and from global economies of scale and scope, which are generated by the scale of operations/sourcing rather than by the low cost of some locations.

Although the preceding arguments are well documented, some questions remain. First, these arguments mainly take the perspective of the MNC corporation or HQ. It is not clear if the arguments apply to MNC subsidiaries. Because the economic interests and goals of MNC HQs are not always congruent with those of MNC subsidiaries, what is good for an MNC corporation may not benefit their subsidiaries. Secondly, the preceding arguments are mainly developed from MNCs competing in developed countries. Whether or not these arguments apply to MNCs competing in emerging markets remains a question. Emerging markets are characterized by lower labor costs than those of developed countries. In general, emerging markets also lack sophisticated industry infrastructure to supply advanced technologies and manufacture high quality products. Because of these differences, it is important to examine the validity of the preceding global integration arguments in emerging markets.

From the perspective of MNC subsidiaries in emerging markets, the preceding global integration arguments would predict that MNC subsidiaries in emerging markets gain low cost supplies from two sources: local and/or global sourcing.

Local sourcing means that the subsidiaries source supplies from local (host) markets. Local sourcing saves costs because of the low labor costs in emerging markets. Alternatively, the subsidiaries can also gain low cost supplies from **global sourcing** (i.e., getting/sourcing supplies from parents' integrated supplier channels).

In fact, MNC supplier channels may not need to locate in low-cost countries to be cost competitive, because global economies of scale may lead to competitive costs. For example, as developed countries frequently have superior technology and human capital, sourcing from these countries may enable MNC subsidiaries in emerging markets to enjoy better quality and lower defect rates that result from these global economies of scale – thus reducing the overall sourcing costs. Theoretically, MNCs in emerging markets do not gain extra cost advantage over local firms through local sourcing because both local and multinational firms in such markets enjoy the same low labor costs from the local markets. As a result, global sourcing becomes an alternative source for MNC subsidiaries to gain cost advantages over local competitors because local competitors do not have the global sourcing opportunity as do MNCs. When using global sourcing, MNCs pay high monitoring, coordination and transportation costs. Further, emerging markets frequently have high tariffs. These factors make it unclear if MNC subsidiaries in emerging markets are able to gain cost advantages through global sourcing.

In addition to sourcing, the impact of other types of integration on subsidiaries' costs is not clear. For example, will high level HQ control in subsidiary management, a type of operation integration, improve the efficiency of a MNC subsidiary in an emerging market? Similarly, different levels of integration by the parent may exist where some of MNC's subsidiaries only sell to local markets while the MNC's other subsidiaries sell their products through the parent's global networks. It is not clear if and how such a difference affects the costs of the subsidiaries in emerging markets. Given that existing studies are inconclusive on global integration and its impact on costs of MNC subsidiaries in emerging markets, this paper will examine these issues. MNC subsidiaries in emerging markets suffer from cost disadvantages when they source (or rely upon suppliers) from centralized corporate networks and when HQs exert control through sending expatriates to the subsidiaries. On the other hand, if the subsidiaries are able to use their parents' networks to export products to foreign markets or to sibling subsidiaries, the subsidiaries are able to reduce their costs.

The integration-responsiveness framework is one of the most widely used frameworks to explain the strategies and organizational settings of multinational corporations. The concept was developed in the realm of a research program at the Harvard Business School starting in the mid-1970s. The core idea of the framework is simple: MNCs, while going abroad, are subject to conflicting pressures for cross-border integration and local responsiveness, with industry characteristics defining where strategy is leaning to. Or putting it differently: industry characteristics define to what extent and in what combination MNC strategies seize advantages through cross-border integration and local responsiveness. While the integration-responsiveness framework concept was developed on a solid empirical base, development and usage of the concept in later research has been rather fragmentary. Attempts to differentiate the framework e.g. to better cope with the diversity of strategic choices and organizational forms available to managers or by incorporating the concept of organization justice, did not lead to a broad empirical application of the framework. Moreover, some attempts to classify different industries according to the key driving factors for global integration and local responsiveness came to a halt in the mid-1990s. The starting point for the integration-responsiveness framework was the insight that managers in large multi-business MNCs (also called diversified MNCs or DMNCs) simultaneously have to cope with a diversity of businesses and a diversity of national markets, leading to a strong complexity of decision making. Thereby, the proclaimed aim of the framework is a clear managerialist one.

In essence, the integration-responsiveness framework is about describing the characteristics of a business and deriving feasible strategies from these insights. A business is defined as a set of related product markets and tasks, while an industry is typically comprised of a number of different businesses (or strategic business units/product divisions, if seen from the perspective of a company). The characteristics of a particular business are made up by a set of relevant economic, political and organizational imperatives that shape strategy making.

Examples for these imperatives are put together in the table shown below:

Economic imperatives	***Political imperatives***	***Organizational imperatives***
Technological changes Economies of scale Minimum volumes Factor cost advantages Distribution networks	Home and host government restrictions (e.g. restrictions on M&A, market protection)	Different capacities of organizations to cope with strategic change
Customer demand (universal vs. local) Access to raw materials and talent	Home and host government incentives (public procurement, subsidies)	Resistance from internal stakeholders (particular departments, particular management strata, labour representatives)

Such imperatives translate into twin pressures for the cross-border integration (and coordination) of activities and a need to respond to local and even organizational demands, with the latter - as a managerial issue - neglected in the framework. What is important to emphasize is the fact that the pressures for integration and responsiveness are understood as working in opposite directions. While the core aspect of cross-border integration and coordination is to exploit arbitrage advantages across nations, by centralizing and coordinating activities, local responsiveness means differentiation through local adaption and local presence.

The notion of global integration refers to centralized management of geographically dispersed activities in the value chain on a regular basis. It appears when MNCs aim to reduce costs and optimize investment. Typically, it involves the relocation of parts of the production or the service chain across borders to countries with more suitable factor endowments for this particular activity. In the past such factor endowments often consisted in lower wages. However, in other cases, it has been the access to particular technologies or skilled labor that led to cross-border relocations. A second trigger for global integration is the building of highly specialized large scale plants that realize economies of scale and serve multiple national markets from one location.

Global coordination does not involve an integration of activities across borders such as a central plant serving multiple markets or a particular country providing a particular input such as low labor cost. Rather it refers to the central management of assets that are dispersed over countries and divisions. Hence global coordination is about regulating the activities and the co-operation of dislocated assets in order to achieve economic benefits. This is a typical headquarters' task. Examples of global coordination involve the coordination of R&D projects across several R&D facilities of the MNCs as well as the coordinated setting and transfer of standards/targets for almost all corporate functions involving e.g. sourcing, pricing, HRM practices. Businesses that need significant global integration of activities also require global strategy coordination. Here we can add that while global integration might always involve a certain degree of global coordination, a global coordination of activities might also occur without a global integration of activities in a downstream to overall management.

Local responsiveness refers to a situation in which advantages through global integration are absent, out of reach or the attempt to realize such advantages is even detrimental. In such cases, decision making is shifted to subsidiaries, albeit headquarters might still keep monitoring or even coordinating such activities. Local responsiveness extends to both products/services that take a local shape and the business processes which are shaped by national regulations. Local responsiveness is typically needed if activities do not allow for economies of scale, or when regulations, customer demand and distribution systems are locally specific.

Types of subsidiaries

In the corporate world, a subsidiary is a company that belongs to another company, which is usually referred to as the parent company or the holding company. The parent holds a controlling interest in the subsidiary company, meaning it has or controls more than half of its stock. In cases where a subsidiary is 100% owned by another firm, the subsidiary is referred to as a wholly owned subsidiary.

The multinational corporation is a fixture of United States culture. Many goods, services and food products are produced by large companies like Coke and John Deere. Their reach is not limited to the U.S. or even to this hemisphere. Through subsidiaries, these companies sell their wares all over the world. Having a subsidiary can mean more than just brand extension for companies. It means having an ongoing financial and operational presence abroad.

A multinational can form a subsidiary by negotiating with a foreign government to open an office or production facility in the country. In return, the multinational may receive financial incentives to locate in a certain area. Other times, a multinational may have a controlling interest in a smaller foreign company but choose not to merge with the company. This could be because there is a significant difference in the brands or the products the two produce. A multinational will form a subsidiary to produce goods and services that cannot be produced in its home country. Having a subsidiary can also serve as a mechanism to enter a new market, rolling out a limited number of products before establishing the parent company's full line abroad.

The main reason for subsidiaries is economics. Of the incentives a country can offer a multinational are tax incentives. The country may offer the business a lower rate or a number of years without national taxes to aid in establishing the subsidiary. Corporations also create subsidiaries for the specific purpose of limiting their liability in connection with a new product or just for operating in a new country. The parent and subsidiary have separate legal identities, which means one is not liable for the actions of the other. The parent company is not completely shielded. Creditors can sue the parent if the subsidiary fails or cannot meet its obligations.

There are three types of subsidiaries: Wholly Owned Subsidiaries, Partly Owned Subsidiaries, and Joint Venture Subsidiaries.

Wholly Owned Subsidiaries

A wholly-owned subsidiary is 100 percent owned by the parent company that created it. The parent company has complete control over the subsidiary, including all board seats and voting rights.

Partly Owned Subsidiaries

A partly owned subsidiary is not completely controlled by its parent company. It usually has one to 49 percent ownership of its stock, but the parent company has the controlling votes in major decisions.

Joint Venture Subsidiaries

A joint venture subsidiary is created by two companies, each of which owns half of the subsidiary's stock. Each parent company appoints only half of the board members and has one vote in major decisions.

There are many reasons why companies create subsidiaries. Subsidiaries may be created to:

- Market a company's products and services in other countries.
- Operate in particular industries where the parent already has strengths such as customer bases. Subsidiaries can also allow a business to diversify its portfolio by selling different kinds of products or services.
- Operate in different geographic areas so the parent company doesn't have to have offices all over the world. Subsidiaries are great for expanding into new markets because the parent company has less risk.
- Take advantage of favorable tax laws in other countries where a subsidiary is located. Subsidiaries may be able to benefit from lower corporate tax rates or other benefits

The advantages of Subsidiary Companies are as follows:

- Subsidiaries are separate legal entities, so they can make decisions without needing to seek permission from the parent company every time.

- Subsidiaries offer existing companies the chance to enter new markets or product lines without having to create a completely new business with employees and everything else that goes into it.

- Subsidiary companies can help the parent company cut costs by eliminating redundancies in overhead expenses. Subsidiaries can also take advantage of economies of scale to reduce their operating costs.

- Subsidiaries are not directly affected by economic downturns, recessions, or market fluctuations because they operate separately from other components within the parent company.

The disadvantages of Subsidiary Companies are as follows:

- A Subsidiary is a new company, so it requires a significant financial investment from the parent company at its formation. Subsidiaries also require additional investments as they grow and expand.

- Subsidiaries have separate management teams, so they may not be equipped to handle some of the demands of operating within an international business structure.

- Subsidiaries are separate legal entities so they have their own set of responsibilities and liabilities that are often more rigorous than those of a parent company.

- Subsidiaries will also be held responsible for any negligence or misconduct on their part, while the parent company will not be held responsible for Subsidiary actions.

- Subsidiaries are taxed at a separate rate from their parents. Subsidiaries pay all federal taxes on the income they make in addition to state taxes and any other applicable fees or fines.

Subsidiary Companies offer existing businesses a chance to enter new markets or product lines without having to create a completely new business structure from scratch. Subsidiaries allow parent companies to cut costs by eliminating redundancies in overhead expenses and taking advantage of economies of scale. Subsidiaries can also help the parent company to reach global markets with ease and adapt quickly to changes in the market.

Control of subsidiaries

In the past 20 years, the rapid development of communication technology and shifts in worldwide markets have combined to create the perfect scenario for a fully globalized economy. Organizations have been keenly aware of these conditions, and have responded by expanding their operations overseas, resulting in a proliferation of corporate subsidiaries around the world. In addition to these offshore ventures, corporations establish domestic subsidiaries through mergers and acquisitions or to take advantage of the considerable tax savings a subsidiary can provide.

This abundance of subsidiaries presents an increasingly complex landscape for corporate management, particularly in regard to governance and compliance. Subsidiaries operate in the shadow of their parent company, and so corporate management must try to satisfy both the demands of the parent organization's primary mission and the goals of the individual subsidiary.

Acquiring this balance is often more difficult than it sounds. Corporations want to establish governance principles that reflect the parent company's business ethos while respecting the individual intricacies of each subsidiary, including the regulatory requirements of its particular jurisdiction and the cultural factors that may affect its operation.

The three strategies employed by successful corporations to rein in the task of effective subsidiary management are discussed as below:

Strategy #1: Formation of Separate Boards for Subsidiaries

One initial decision a corporation must make when establishing a subsidiary is whether or not to form a board separate from that of the parent company. Sometimes, local laws and regulations mandate this decision from the beginning. For example, in many jurisdictions, all companies must have a board of directors, and in some cases, companies are required to people those boards with at least some local directors.

Though these boards provide some measure of localized control over the workings of the company, board actions are expected to follow the same overall governance principles established by the parent company, and board members should perform their roles in the same spirit as required under overall corporate regulations.

When establishing subsidiary boards, corporations should pay special attention to the composition of the board, particularly in regard to the mix of parent company and local directors. In making these decisions, organizations must find a balance between two often-competing obligations. On the one hand, the parent company must maintain executive control over the strategic direction of the company as a whole. On the other, for effective board oversight, the subsidiary boards need to do more than just reflect the general will of the parent company.

As noted before, in some jurisdictions, companies are required to include a certain percentage of local representation on the board, particularly in the case of establishing overseas subsidiaries. But even in domestic subsidiaries, a healthy mix of local and parent company representatives seems to be advantageous for both the individual subsidiary and the organization as a whole. Common solutions to this challenge include the inclusion of non-executive board members to the subsidiary board, or the selection of common board members, who serve on both the parent company board and the subsidiary board.

Strategy #2: Foster a Mutually Beneficial Parent-Subsidiary Relationship

Part of managing the interactions between the parent company and the subsidiary lies in understanding the ways that each may help the other to achieve more lasting success. The first step in this process is to identify and consider the parent subsidiary matrix from their respective perspectives. This recognition can facilitate discussion and create an environment of shared understanding and acknowledgement.

This attitude of mutual respect can be essential to the process of defining or redefining the role of the subsidiary so that it aligns with the parent company's overall business strategy. A key element to this realignment is to recognize and evaluate the possible contribution and capabilities of the subsidiary. A subsidiary's role within the parent group can greatly depend upon the parent-subsidiary relationship, the subsidiary's initiative and acumen, and the parent company's recognition of the subsidiary's ability to contribute. It is also important to recognize that the subsidiary's role in an organization is not static, and often changes as the overall corporation continues to grow and develop.

Strategy #3: Ensure Consistent, Quality Subsidiary Information with Entity Management Technology

In order to meet the many needs of parent companies and all of their affiliated subsidiaries, corporations need access to reliable, accurate entity information. Entity management technology helps coordinate details such as tracking entity life cycle, officer/director appointments, ownership, registration requirements and the ever-expanding landscape of regulatory measures.

Successfully implemented entity management platforms can facilitate all of these functions across time zones, languages and departments. Specifically, entity management technology provides the parent-subsidiary partnership with these essential advantages:

- **Centralized Data Source for Entity Information:** With subsidiaries spread across the globe, it is easy for multinational companies to lose track of their own vital entity information. Without a single repository, individual subsidiaries, or even individual departments, begin to silo their company data, leaving the parent company with a fragmented and incomplete vision of their overall holdings. Entity management technology provides a single source of truth for entity information by creating a repository for all allied documents that can be maintained and updated continuously.

- **Compliance Obligations Management:** Multinational corporations continually struggle to stay abreast of compliance initiatives. The wide array of distinct jurisdictions and regulatory demands makes navigating these requirements more challenging than ever. Failing to meet these obligations could result in slowdowns, fines or other legal action. Entity management technology helps to mitigate these issues, creating an array of automated alerts to make sure the right team members have the information they need to meet regulatory demands. These efforts are made easier by streamlined and automated information updating, assuring that compliance efforts are kept verifiable and complete.

- **Collaboration across the Organization:** Once a corporation adopts a robust entity management system, it is easy to build out the necessary functions to allow for collaboration between subsidiaries. Authorized access points allow members of each subsidiary to communicate and to share vital information no matter where they are in relation to the parent company. In addition, information will also be available to core applications. Entity ownership information synchronizes among all applications to ensure accuracy.

Meeting the challenge of successful subsidiary governance

Market trends all point to the continuing increase of multinational corporations presiding over vast arrays of subsidiary companies. To meet the challenges of managing these endeavors, corporations need firm, able boards of directors, strong parent-subsidiary relationships and effective entity management technology.

The Company's Board of Directors shall be responsible for business management and operation of the Company as well as the operation of subsidiaries in compliance with the main business plan, resolutions of shareholders, laws as well as objectives and Articles of Association of the Company. The Board of Directors are responsible for the operation of the Company and subsidiaries, with details summarized as follows:

(1) The Board of Directors sets the policy to appoint their representative to be the director or executive of subsidiaries and associated companies in order to monitor the operation of such companies to be in line with the Company's policy.

(2) The Board of Directors continues to monitor the operation of subsidiaries or associated companies and sets guidelines to control the operation of such companies for a person who was appointed as the director or executive.

(3) The Board of Directors continues to control the business operation of subsidiaries or associated companies to meet the approved business policy, goals, operation plan, strategy and budget.

(4) The Board of Directors considers designing the organization structure and management of subsidiaries or associated companies to add their business operation efficiency and suit current business circumstances.

(5) The Board of Directors shall consider approving the budget and spending for investment, operations, transactions of acquisition or disposition of assets, borrowing from financial institutions, lending, capital increase and decrease or business closure that may significantly affect subsidiaries or associated companies' operations.

(6) The Audit Committee shall review accuracy and reliability of financial reports, internal control system, internal auditing works, related party transactions, compliance with related law and regulations as well as monitoring and controlling of subsidiaries and associated companies' operations.

(7) The Risk Management Committee shall consider screening the policy and risk management guidelines of subsidiaries and associated companies.

(8) The Board of Directors focuses on improving management as well as providing good corporate governance and efficient risk management system of subsidiaries and associated companies.

(9) The subsidiaries and associated companies must report their performance to the Board of Directors of the Company. Also, the Board of Directors must consider such performance regularly in order to support their planning and goals of business operation in the future.

8.2 MANAGING OF MULTINATIONALS – GLOBAL MANUFACTURING AND SUPPLY CHAIN

- **Optimizing of Supply chain**

  "Global Manufacturing and Supply Chain Management" (GMSCM) is broadly discussed by practitioners and academicians and has gained extensive world-wide recognition of the practices of global supply chain, nonetheless, little is known in the literature concerning the issues and problems currently arising in a global manufacturing and supply chain management. "Global manufacturing and supply chain management" is refers to "design, planning, implementation, control, and monitoring of manufacturing and supply chain activities with the objective of creating net value, creating a competitive infrastructure, influencing worldwide logistics, coordinating supply with demand and measuring performance globally". In 2013, market study firm Price, Water House and Coopers (PWC) released its global supply study which described concerns raised from over 500 surveyed executives, the issues and concerns raised is what one will expect issues concerning cost-effectiveness, cost management, and the customer's satisfaction. However, their fourth concern was also raised per report from the global supply study which indicated a change in global supply chain realities. The respondents used for the study by PWC were not just concerned but worried about flexibility – and yes they should. Because, over the years, globalization has changed the way firms opinion and utilize their supply chains strategies to compete and achieve an upper segment of the entire market shares and this reason has caused the increase in concern. Among the issues arising which poses challenges in the present day global supply chain practices are several which connect directly to the instability of market, economic shrinkages plus uncertain repossession phases, which either in a negative or positive way disturb the method firms manage their distribution system, manufacturing system, invoicing as well as obtaining resources. With so many numerous factors setting in, enterprises must enhance their supply chains strategies, just to remain competitive in this complex business environs.

To increase a firm’s performance, the drivers of supply chain management should be considered as this are very essential. The key drivers of supply chain performance include facility and their locations, transportation, inventory, distribution and information management, sourcing and pricing. And the better the firm is able to manage all of these activities, the better it increase a firm’s performance.

Facilities

Under this component, facilities are termed as a place where finished products are stored, assembled and invented. Proper role management, size, capability then the flexibility of the facility have positive impact concerning supply chain performance. With regards to facilities management, the firm must prove to be quick to respond or more effective, however, not both at same. For instance, supplier of an automobile parts may have lots of warehouses or storage facilities existing closer to the customer in order to provide them with quick and better access to automobile parts. These warehouse structures show how responsive the supplier is in making it possible for his customers to get easy access to what they need, on the other hand, this affects the efficacy of the company. Due to that fact, the company ends up paying a huge cost for the warehousing facility. In order to save cost, they have fewer warehouses located at only strategic points making company more efficient at a reduced cost of warehouses, but its level of responsiveness becomes efficient. It is necessary to note based on the example raised, closure of production, as well as other services, causes an organization to downsize. Therefore, managers should be very careful before closing down a facility because it is the reputation of the company, both strategically and customer wise. There are eight factors that managers can consider in making a decision as to what type of facilities do they have to shut down, expand or acquire. This includes; (a) Plant Size; (b) Site Constraints; (c) Capacity; (d) Labour Productivity; (e) Distance from the Head Office; (f) Age of Building or Plant (g) Remoteness, (h) Grants Elsewhere.

Inventory

A fabric and clothing retailer may think he's being more responsible for storing large quantities of inventory, however, realizes later that the level of his industry's efficiency has reduced owing to high-cost inventory and poor work output. Let's consider perishable inventory for instance. Perishable goods can also be managed in supply chains following in the following six ways: (a) Simplifying inventory procedures; (b) By defining target stock levels and order patterns; (c) Organize and control transparency of inventories; (d); By hiring experienced employees (e) Stocking fresh in addition to check and balance on the shelves; (f) Collaboration with other businesses.

Transportation

By implementing a fast transportation service to deliver goods, an organization can increase its level of responsiveness. However, in the long term efficiency turn out to be extremely low because of the high cost involved in transportation and the likelihood that some goods may get damaged while in transit. A better transportation method for an organization, can be to treat a manufacturing organization on the paradigm of joint route planning. The joint route planning concept makes it possible to enhance efficiency and responsiveness by entering into a partnership with other in similar transportation functions of related goods outside its internal environment. This concept is made possible in two main ways, thus; outsourcing transportation function and secondly engaging in horizontal cooperation with other transportation service providers. Outsourcing implies that the organization contracts with other organization in the distribution of their products within the same distribution line in order to reduce transportation cost. While, Horizontal cooperation denotes that manufacturing firms agree with other firms in a similar business venture for collaboration to distribute their products. The benefit of this partnership to both entities involved is economies of scale by transporting their goods at a reduced cost hence saving more on transportation.

Information

Information from the supplier provides credible information on customer taste that the supplier can use to access responsiveness and efficiency. This is made possible because the supplier anticipates customer demand. Hence, the supplier supplies only what is needed for a particular period. A case in point to support this fact is on 2000 January when the executives of Swedish post-office initiated program which consisted of its customers in coming up with a new transport service. As at the time, the company was losing its clients and wanted to ascertain what requirements and needs its customers wanted to enable the company satisfy them. Therefore, the managers decided to meet with their customers as a means of being able to determine the services that customers demand. The entire process was conducted through the exchange information among firm and customers. Subsequently determining the customer demand, the transportation service was started and use one vehicle instead of five. This has significantly resulted in a cost reduction, environmental pollution problem and as well increased the efficiency of the post services. Information, is potentially the biggest driver of the performance of the supply chain because it directly affect each of the other drivers. Therefore, with the availability of effective information system senior executives have the capacity of making their supply chain more responsive and efficient. One of the good examples we can look at is Seven – Eleven Japan where the company's information system was used to "better match" their supply and demand while they continued to achieve production, as well as distribution savings.

Sourcing

The effectiveness of supply chain performance also depends greatly on the choices of sourcing. Therefore, companies carefully determine which particular activities should be performed or outsourced. Some of these activities could be production warehousing, transportation and even managing information across the supply chain. Strategically these decisions mentioned above determines what types of functions does a company wanted to perform and which should be outsourced. In that sense, firms are careful when it comes outsourcing decisions making because it affects the responsiveness and the supply chain efficiency. Motorola had a bad experience when the company decided to outsource its production activities to a company residing in China. Although the company improved in it efficiency, on the other hand, it suffered a great when it come responsiveness because of its distance of outsourcing.

Pricing

There can be two probable methods of pricing as per transportation channels. One can have a linear pricing method and strategy matrix pricing method. The linear methodology consist of the resulting five stages in determining the right prices. (a) The pricing objectives of the company, (b) policies for pricing, (c) develop a list of prices, (d) discounts, (e) adjustments and final pricing. Whilst, strategy matrix pricing method considers pricing in relation to customer characteristics where a good example is price discrimination.

Barriers in implementation of new supply chain strategies

Some hindrances hamper a firm in its processes of integrating a new supply chain strategy in global supply chain management. In conjunction with identifying these challenges, some corrective processes can be implemented to curb the situation. There are quite a number of factors that can obstruct the process of implementing a new supply chain strategy, especially in situations which might result in misrepresentation of information, Such as long cycle time, stock outs, as well as bullwhip effect. Therefore increasing the cost of productions and reducing customer service capabilities. The following paragraphs outlines four of such impeding factors.

Lack of Trust

A successful process of introducing and implementing a new supply chain strategy, especially in global supply chain management will depend greatly on trust especially where there will be a collaboration between supply chain partners. Trust is considered as the basis for supply chain management. Eventually when trust transpires and grows among supply chain partners, each partner gets trusted therefore building a reputation even among the other companies. Though this might seem to look like a very long shot, the result of trusted relationship would be “Win-Win” or “Win-Win-Win” situations among supply chain partners. Spalding Holding co-operates with Wal-Mart, and this alliance leads to a win-win on behalf of both partners. Wal-Mart provides Spalding with its collected data on and forecast as well as point-of-sale data, this makes it possible for Spalding to reduce its inventory levels in order to meet Wal-Mart’s requirements as expected. The consequence is that, Wal-Mart will stock out Spalding’s goods less often, since Wal-Mart has now well understood Spalding’s capability as well as the cost. Sadly enough, this situation is not similar to other firms, some practices of firms and human nature in these firms will not change overnight. Owing to this some firms have issues with trust when it comes supply chain processes, and can lead to an uphill battle. For instance, Boeing has been trying to get past its trust issues with some of its suppliers over the years. The engineers at Boeing pass on Boeing designs materials to their suppliers every now and then as if they were in the same company.

Lack of knowledge.

Furthermore, most firms have been heading towards collaboration in global supply chain management for some time now, and it is recently that technology has become the backbone of supply chain and has wedged up with this vision. Lack of knowledge in the core principle of supply chain management principles was the greatest obstacle. Furthermore, as companies create and implement new supply chain strategies, they introduce and implement various changes without employee involvement, for instance, ERP applications for production. Employee’s resistance to these changes will affect the entire supply chain performance if they are not involved in the change. As a result, firms must realize the need and importance of educating as well as involving employees who will be using the system in relations to purchasing decision-making, training, and implementation processes. For most firms, a prosperous “supply chain management” needs a contingent continuous employee training and research. Therefore when educational, research in addition training is taking out the company’s calendar its affects the innovation of the firm’s, and the competitiveness of the “supply chain” since innovation is the fuels of competitiveness.

Silo mentality

Once more, another factor that impedes implementing a new supply chain management strategy is the “Silo Mentality”. “Silo-Attitude” portrays a situation where companies turn to engage the use of cheaper contract suppliers. Therefore, paying very little or without no consideration for the requirements of the consumer, plus allocating little resources to new services and products design. The end results are that, production costs are increased, poor timing of delivery that turn to have negative impact other customer service as well, damages the implementation process of a new supply chain strategies. Silo mentality is the major barrier in overcoming the implementation a new supply chain strategy for most companies. This silo effect is usually seen in departmental units. For instance, the transport manager, could be trying to reduce entire yearly transportation overheads whereas accidentally triggering the safety-stocks to rise, causing deficiencies to take place that affects as well as deteriorate consumer services level. In order to overcome this barrier, companies must find all means possible in aligning their supply chain objectives and incentives of the company. Lastly manager’s performance reviews must include their capability to mix processes externally and internally plus the ability to meet the whole supply chain objectives.

Disruptions in global supply chains and the resilience required to overcome these disruptions

Supply chain management have been the motivation of diverse businesses in the most current two eras. The globalization of businesses, outsourcing inside capabilities in addition to diminishing the buffer levels over the chain through just-in-time philosophy are the illustrations of such configurations. The context includes two main vantage point in managing disruptions in the supply chain, namely pre-and post-disruption perspectives, that are commonly treated as separate in the existing frameworks. Addressing the disruptions in the supply chain takes different forms and also take different methods in addressing such disruptions. Disruptive activities in the supply chain can be considered "predisruption" as well as "post-disruption". Most companies have taken measures to curtail these disruptions beforehand to minimize the exposure to potential disruptions that may arise. Nonetheless, despite all efforts, disruptive events still occur and its occurrence influences supply chain operations. This most important thing is to manage the disruptions to restore the system to normality. This approach is in line with another method which is Proactive (Predictive) vs. Reactive assessment to manage the supply chain risk and disruptions. A proactive risk management involves, in taking precautionary measures in tackling the risk of disruptive actions whereas reactive means to react to an event once it's materialized. The disruptions to complex supply chains drive as far as to natural disasters and life threatening climate conditions, this are threats not only to supply chains but also other operational areas of a company. A systemic predisposition, such as dependency on oil plus information breakup, as well pose grave threats. As political instability, cyber-crimes and the increasingly alarming insurance cost, and financing trades activities do. Protection over disruption in supply chains is a priority for every firm. Across the world, there have been global procedures that firms can take to address supply chain and make it more robust. Institutionalizing of risk evaluation processes in a broad-based, neutral international body, otherwise intensify platforms where data sharing can be utilized for identifying risks then react to it. The proper approaches for management supply chain risk depend on determining the probability of manifestation and extent of the impact of each prospective occurrence which may considerably disrupt the operations of a company. These disruptions include transportation breakdowns, poor suppliers' performance, and errors in the forecast and the alike. Elements of what is considered as dynamic operations can help accomplish mitigating the impact of supply chains disruptive events: Operators in the line of supply chain are better be able in creating external in addition to internal data that will make it potential for them to be able to act rapidly to curtail the negative impact of disruption. Organization's supply chain structure should be flexible and simple in that way it could be easily adjusted if there should be. Since a successful and effective supply chain should be adapt to changes in this complex environment in addition to able to respond to the economic and market changes. These structures include a well-defined corporate structure and departments with clearly outlined duties and responsibilities that can help decrease confusion and speed up processes when the destructive situation arises.

In order to guarantee an effectiveness, supply chain executives could organize the sharing strategic stocks among themselves, otherwise better still enter into an agreement of shared supply strategic stock. Pre-arrangement to access these critical stocks, like emergency medical, as well as fuel supplies. Stable access to Information Technology is critically another way to address issues that arise from disruptions that affect the supply chain. Information Technology can improve supply chain flexibility through analyzing data and sharing information, modeling scenarios, as well as preprogrammed replies. Despite supply chain manager's fears that introducing resilience into their supply chain will lead to high cost plus reduce potential rewards, however, most experts' advised that resilience and efficiency can coexist devoid of major adverse impact on the supply chain. Measures need to be taken to enhance supply chain resilience – for example, creating an attitude of cultural risk, enhanced awareness as well as cautionary structures; for identifying and removing supply chain hold-ups; and enhanced information distribution amongst administration as well as industries – will be considered good corporate practices, in addition, essential preparedness measures.

- **Offshoring V/S Outsourcing**

  One of the most commonly misunderstood aspects of the global supply chain is the difference between off sourcing and outsourcing. A surprisingly large proportion of the general public confuse these terms. But they are distinct concepts.

  Procurement Leaders research finds that consumers often use business terms without a fine degree of differentiation. In the main, they are viewed negatively and all representative of the malignant campaign of corporations to 'screw over the little guy'. Often, they don't see the difference at all between 'outsourcing' or 'offshoring'. For one American respondent, they were all part of the same malaise:

Businesses do it for money and don’t care about consumers. They are not honest about their products most of the time.” This is an unfortunate misunderstanding as knowing the difference between these concepts can enrich our knowledge of business. From here, we can truly appreciate the positives and negatives of business activities, and cut across the political verbiage. So, what is outsourcing? And how does it differ from offshoring?

Offshoring is the act of delegating part of business work to an external and/or internal entity that is located somewhere else. Outsourcing involves obtaining certain services/products from a third party, while offshoring companies relocate some of their services/product lines to regions that offer them a competitive advantage. Due to the unifying factor of competitiveness, offshoring and outsourcing can be entangled, leaving a very thin line to separate them—especially in the service sector. Offshoring-outsourcing can involve captive outsourcing, nearshoring, and on shoring, depending on the location of the firm. By 2019, India was the number one destination for most offshore-outsourcing activities, owing to its financial attractiveness and skilled labour.

Outsourcing

At its most basic, outsourcing is about moving internal operations to a third-party. This can come in the form of selling physical plant to a supplier, to buy back goods or services, or shifting an entire business division to a third-party and again buying the service back. The basic philosophy being: To move transactional activities to the experts in order to give an organization the capacity to focus on its expertise.

The pattern of decade’s worth of trade has been based upon this ideal. Almost every company has 'spun off' its functions and sort greater specialization on the areas which earns the most profit. In turn, outsourcing has generated fantastic wealth for the global economy.

There are down-sides. Although a company can expect to see a reduced cost profile, it does lose its own capabilities. Once you move your productive facilities to a supplier, you also outsource all the knowledge and human capital to make those goods. Such capabilities may have taken decades to create. Once lost, they are hard to return.

Critics also argue that outsourcing equates job losses. The act of outsourcing is, generally, laying-off a number of people (as well as selling property). These workers face an uncertain future of possibly retaining their jobs with the new supplier, or perhaps being made completely redundant.

Offshoring

Unlike outsourcing, offshoring is primarily a geographic activity. In the West, goods are expensive because the staff required to produce and distribute them are costly. In the developing world, by contrast, vast inexpensive labor pools provide an easy bedrock for a low-cost economy.

Offshoring takes advantage of these cost differentials by relocating factories from costly countries to the cheaper economies in order to sell the goods back in the West at a hefty discount (and profit). Alongside technological improvements, it has been the decades of productive offshoring that has lowered the costs of consumer goods such as clothing and electronics.

Offshoring does not only relate to the production of physical goods, but also services. The Indian IT industry, for instance, has been powered by waves of offshoring by technological companies in the West.

As with outsourcing, the activity has the potential to save money for both seller and consumer. Advocates also argue that these actions can stimulate wealth in some of the world's poorest countries and provide jobs for those who are in the deepest need of aid.

Critics contend that this is merely self-serving rhetoric and that offshoring is a device to exploit some of the world's most vulnerable populations. Workers from such countries have no legal protection and face either harsh conditions or hunger. Examples such as Apple's supplier Foxconn, which experience a sleight of suicides at its Chinese facilities testifies to the severity of treatment.

Combining offshoring and outsourcing

The ultimate means to save a significant amount of money is to combine offshoring with outsourcing. That is, move production to a third-party that is based in an overseas location. This has been an activity in which American corporations have been engaged for many decades. Last swatches of US industry has been relocated under the production of overseas entities, mainly in China.

Although double the savings may be enjoyed here, so are double the cost. Opponents argue that the costs are not only felt by companies, but by entire nations. The dramatic change in the American political climates, for instance, is partly attributable to the enormous public opposition to outsourcing to offshore locations. It is important to know the difference between these terms when engaged in the political debate on business strategies. There are both moral and economic implications of offshoring and outsourcing, but they are distinct. And an enriched discussion will be mindful of these differences.

Pros and cons of offshoring and outsourcing

There are advantages and disadvantages businesses should consider when it comes to outsourcing and offshoring.

Potential advantages of offshoring:

- **Lowers labor costs**. One of the potential advantages of offshoring is that businesses could save money by hiring foreign workers to do the same work for less money than it may cost in North America.
- **Establishes new markets**. Setting up an offshore presence may enable a company to broaden its customer base to other countries.
- **Enhanced knowledge of overseas markets.** Foreign employees may offer a better understanding of the regional trends, markets, business risks and cultural norms in their country than North American employees
- **Alternate tax and regulatory benefits.** Several countries offer tax breaks and financial incentives to entice foreign companies.

Potential advantages of outsourcing:

- **Frees up in-house resources.** By shifting some of the workload to an outside source, businesses can focus more on growth strategies.
- **Lowers operational costs.** One of the potential advantages of outsourcing is that contracting out work could lower overhead expenses and the need for additional in-house employees.
- **Provides access to outside expertise.** Outsourcing offers companies the opportunity to hire a vendor that specializes in a skill their company lacks.
- **Faster service**. A specialized offsite vendor may have the talent and resources to complete a task faster and more efficiently.

Potential disadvantages of offshoring:

- **Regulatory differences.** There are also foreign laws and risks that may impede standard North American business practices.
- **Time zones.** Working with overseas employees may mean having to make calls at inconvenient times in order to reach them during their normal business hours.
- **Exchange rates.** The highs and lows of currency valuation can make a significant dent in overseas transactions and may offset savings.

Potential disadvantages of outsourcing:

- **Security risks.** Entrusting an outside firm with sensitive company information may increase the chances of a security breach.
- **Loss of control.** Delegating responsibilities to an offsite vendor can make it difficult to monitor progress and maintain quality control.

- **Lack of institutional knowledge.** A company's interests may not align with those of an external organization, which lacks the firm's in-house insights.

- **Intellectual property concerns.** Sharing ideas and data with a third party can make it difficult to protect intellectual property.

8.3 SUMMARY

The unit has discussed in detail the concepts about the Integration Response Models in terms of types of subsidiaries and control of subsidiaries and the key aspects of global manufacturing and supply chain in terms of optimization of performance and offshoring and outsourcing strategies.

For MNCs the concept of global integration response model has been explained. It is seen that the management power in the multi-national corporation is primarily centralized at the MNC headquarters (HQ). MNC subsidiaries have little flexibility or autonomy. In the localization model, on the other hand, the MNC HQs do not standardize the business activities of their subsidiaries, and the subsidiaries therefore enjoy more freedom and autonomy than that in the integrated model.

There are three types of subsidiaries: Wholly Owned Subsidiaries, Partly Owned Subsidiaries, and Joint Venture Subsidiaries. A wholly-owned subsidiary is 100 percent owned by the parent company that created it. A partly owned subsidiary is not completely controlled by its parent company. A joint venture subsidiary is created by two companies, each of which owns half of the subsidiary’s stock.

Subsidiaries operate in the shadow of their parent company, and so corporate management must try to satisfy both the demands of the parent organization’s primary mission and the goals of the individual subsidiary.

The Company’s Board of Directors shall be responsible for business management and operation of the Company as well as the operation of subsidiaries in compliance with the main business plan, resolutions of shareholders, laws as well as objectives and Articles of Association of the Company.

Global manufacturing and the supply chain’s performance can be optimized by considering the drivers of supply chain. The key drivers of supply chain performance include facility and their locations, transportation, inventory, distribution and information management, sourcing and pricing. And the better the firm is able to manage all of these activities, the better it increase a firm’s performance.

Outsourcing is about moving internal operations to a third-party. This can come in the form of selling physical plant to a supplier, to buy back goods or services, or shifting an entire business division to a third-party and again buying the service back.

Offshoring is primarily a geographic activity. In the West, goods are expensive because the staff required to produce and distribute them are costly. In the developing world, by contrast, vast inexpensive labor pools provide an easy bedrock for a low-cost economy

8.4 EXERCISES

Q.1. What do you understand by a subsidiary?

Q.2. Discuss the different types of subsidiaries.

Q.3. Explain the important considerations for the control of subsidiaries.

Q.4. Define global manufacturing and explain its importance in optimizing global supply chain.

Q.5. What is the difference between offshoring and outsourcing?

8.5 SUGGESTED READING

a. International Business - Mike W. Peng; Klaus E. Meyer - Cengage Learning

b. International Business Environment, The: Text and Cases- J Stewart Black ; Anant K Sundaram – Prentice Hall India

c. International Business –Charles W L Hill - McGraw Hill

d. International Management - Arvind V Pathak – TMH

e. The Cultural Dimension of International Business – Gary P Ferraro – Pearson

f. Multinational Management – John B. Cullen _ Thomson

g. International Business: Challenges and Choices - Alan Sitkin, Nick Bowen – Oxford Press

❄❄❄❄❄❄❄