International Business

Unit 1

Introduction and International Business Environment

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International Business– An Overview

- International business refers to the **business activities or transactions carried out beyond the national borders of a country.**
- It is a much wider term comprising of all the **commercial transactions taking place between two countries.** International business can occur in different modes which can be **exporting, licensing, contract, manufacturing, foreign assembly foreign production, joint venturing**, and others.
- For a study of international business or trade, it is necessary to **understand the nature and extent of economic interdependence among countries**.
- Countries depend on each other for a variety of economic transactions that is transactions and goods and services and capital being a part of world economy.
- No Country can live in economic isolation or referred to keep out of a global economy no country is self sufficient in regard to its requirement nor can it consume all that it produces**.**

International Business– An Overview

- In other words interdependence of countries is reflected in the whole range of international transactions.

- Therefore international business is a **combination of all commercial transactions either private or government between two or more countries it is the exchange of capital goods and services across the international borders or territories.**

- These transactions are **conducted at the global level & across national borders**. International businesses are very large in size as they are performed at a global level.

- Their scales of operation are vast in size. International businesses provide employment to a large number of peoples. It is served as an important source for earning foreign exchange for the country. All payments in these businesses are done in foreign currencies of different countries.

- These businesses **help in improving the standard of living of people** in different countries **by supplying high-quality goods.**

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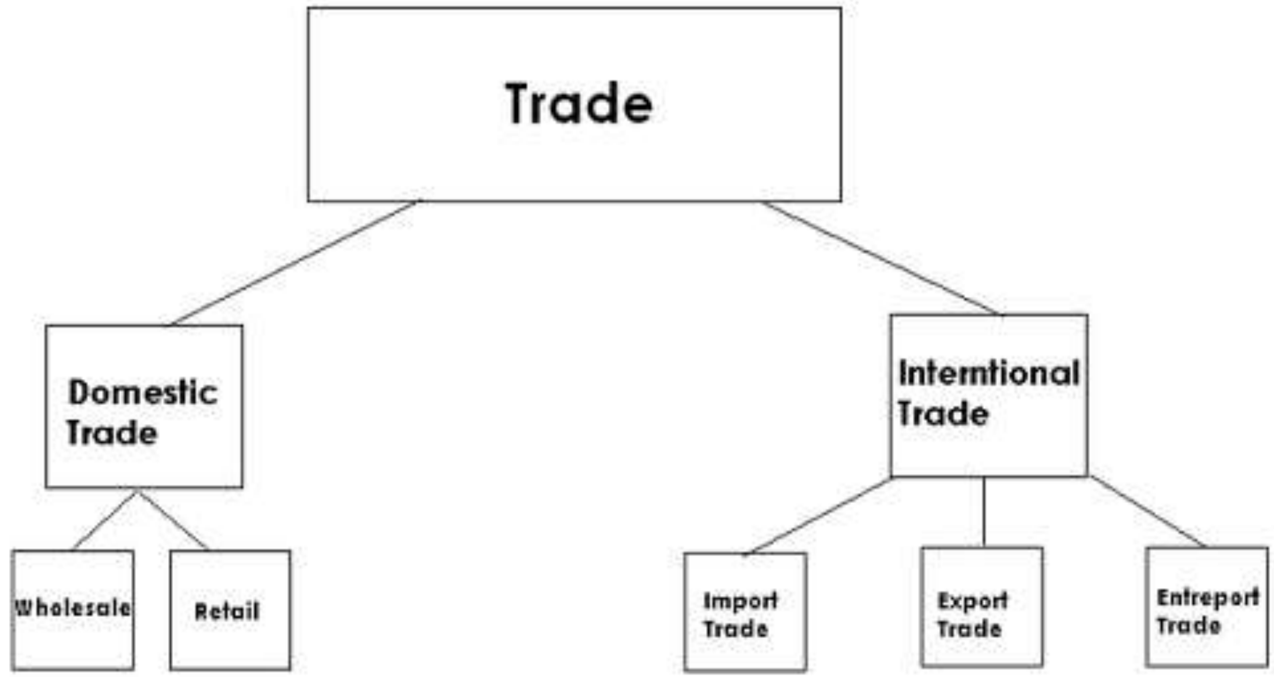


- **It is of three types:**
- **Export Trade** – It is selling of goods and services to foreign countries.
- **Import Trade** – It is buying goods and services from other countries.
- **Entreport Trade** – It is import of goods and services for re-export to other countries.

- **Definition of Domestic Business**
- The business transaction that occurs within the geographical limits of the country is known as domestic business. It is a business entity whose commercial activities are performed within a nation. Alternately known as internal business or sometimes as home trade.
- The producer and customers of the firm both reside in the country. In a domestic trade, the buyer and seller belong to the same country and so the trade agreement is based on the practices, laws and customs that are followed in the country.
- There are many privileges which a domestic business enjoys like low transaction cost, less period between production and sale of goods, low transportation cost, encourages small-scale enterprises, etc.
- **Definition of International Business**
- International Business is one whose manufacturing and trade occur beyond the borders of the home country. All the economic activities indulged in cross-border transactions comes under international or external business. It includes all the commercial activities like sales, investment, logistics, etc., in which two or more countries are involved.
- The company conducting international business is known as a multinational or transnational company. These companies enjoy a large customer base from different countries, and it does not have to depend on a single country for resources.
- Further, the international business expands the trade and investment amongst countries.

Key Differences Between Domestic and International Business

- The most important differences Between domestic and international business are classified as under:
- Domestic Business is defined as the business whose economic transaction is conducted within the geographical limits of the country. International Business refers to a business which is not restricted to a single country, i.e. a business which is engaged in the economic transaction with several countries in the world.
- The area of operation of the domestic business is limited, which is the home country. On the other hand, the area of operation of an international business is vast, i.e. it serves many countries at the same time.
- The quality standards of products and services provided by a domestic business is relatively low. Conversely, the quality standards of international business are very high which are set according to global standards.
- Domestic business deals in the currency of the country in which it operates. On the contrary, the international business deals in the multiple currencies.
- Domestic Business requires comparatively less capital investment as compared to international business.

Key Differences Between Domestic and International Business

- Domestic Business has few restrictions, as it is subject to rules, law taxation of a single country. As against this, international business is subject to rules, law taxation, tariff and quotas of many countries and therefore, it has to face many restrictions which are barriers in the international business.
- The nature of customers of a domestic business is more or less same. Unlike, international business wherein the nature of customers of every country it serves is different.
- Business Research can be conducted easily, in domestic business. As against this, in the case of international research, it is difficult to conduct business research as it is expensive and research reliability varies from country to country.
- In domestic business, factors of production are mobile whereas, in international business, the mobility of factors of production are restricted.

International Business – Meaning and Definitions

- International business refers to those business activities that take place beyond the geographical limits of a country.
- “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**
- Thus, it involves not only the international movement of goods and services, but also of capital, personnel, technology and intellectual property like patents, trademarks, knowhow and copyrights etc.
- It is a business which takes place outside the boundaries of a country, i.e., between two countries.
- It includes the international movements of goods and services, capital, personnel, technology and intellectual property rights like patents, trademarks and knowhow.
- It refers to the purchase and sale of goods and services beyond the geographical limits of a country.

Features of International Business

1. Large Scale Operations
2. Intergration of Economies of Many Countries
3. Dominated by Developed Countries and MNCs
4. Benefits to Participating Countries
5. Keen Competition
6. Special Role of Science and Technology
7. International Restrictions
8. Sensitive Nature

- **Large scale operations**: In international business, all the operations are conducted on a very huge scale. Production and marketing activities are conducted on a large scale. It first sells its goods in the local market. Then the surplus goods are exported.
- **Integration of economies** : International business integrates (combines) the economies of many countries. This is because it uses finance from one country, labour from another country, and infrastructure from another country. It designs the product in one country, produces its parts in many different countries and assembles the product in another country. It sells the product in many countries, i.e. in the international market.
- **Dominated by developed countries and MNCs** : International business is dominated by developed countries and their multinational corporations (MNCs). They also have the best technology and research and development (R & D). They have highly skilled employees and managers because they give very high salaries and other benefits. Therefore, they produce good quality goods and services at low prices. This helps them to capture and dominate the world market.
- **Benefits to participating countries** : International business gives benefits to all participating countries. However, the developed countries get the maximum benefits. The developing countries also get benefits. They get foreign capital and technology. They get rapid industrial development. They get more employment opportunities. All this results in economic development of the developing countries. Therefore, developing countries open up their economies through liberal economic policies.

- **Keen competition** : International business has to face keen competition in the world market. The competition is between unequal partners i.e. developed and developing countries. In this keen competition, developed countries and their MNCs are in a favourable position because they produce superior quality goods and services at very low prices. Developed countries also have many contacts in the world market. So, developing countries find it very difficult to face competition from developed countries.
- **Special role of science and technology** : International business gives a lot of importance to science and technology. Science and Technology (S & T) help the business to have large-scale production. Developed countries use high technologies. Therefore, they dominate global business. International business helps them to transfer such top high-end technologies to the developing countries.
- **International restrictions** : International business faces many restrictions on the inflow and outflow of capital, technology and goods. Many governments do not allow international businesses to enter their countries. They have many trade blocks, tariff barriers, foreign exchange restrictions, etc. All this is harmful to international business.
- **Sensitive nature** : The international business is very sensitive in nature. Any changes in the economic policies, technology, political environment, etc. has a huge impact on it. Therefore, international business must conduct marketing research to find out and study these changes. They must adjust their business activities and adapt accordingly to survive changes.

Importance of International Business

1. Earn Foreign Exchange
2. Optimum Utilisation of Resources
3. Achieve its Objectives
4. To Spread Business Risks
5. Improve Organisation Efficiency
6. To Get Benefits from Government
7. Expand and Diversify
8. Increase Competitive Capacity

- **Earn foreign exchange**: International business exports its goods and services all over the world. This helps to earn valuable foreign exchange. This foreign exchange is used to pay for imports. Foreign exchange helps to make the business more profitable and to strengthen the economy of its country.
- **Optimum utilisation of resources**: International business makes optimum utilisation of resources. This is because it produces goods on a very large scale for the international market. International business utilises resources from all over the world. It uses the finance and technology of rich countries and the raw materials and labour of the poor countries.

- **Achieve its objectives**: International business achieves its objectives easily and quickly. The main objective of an international business is to earn high profits. This objective is achieved easily. This it because it uses the best technology. It has the best employees and managers. It produces high-quality goods. It sells these goods all over the world. All this results in high profits for the international business.
- **To spread business risks**: International business spreads its business risk. This is because it does business all over the world. So, a loss in one country can be balanced by a profit in another country. The surplus goods in one country can be exported to another country. The surplus resources can also be transferred to other countries. All this helps to minimise the business risks.

- **Improve organisation's efficiency**: International business has very high organisation efficiency. This is because without efficiency, they will not be able to face the competition in the international market. So, they use all the modern management techniques to improve their efficiency. They hire the most qualified and experienced employees and managers. These people are trained regularly. They are highly motivated with very high salaries and other benefits such as international transfers, promotions, etc. All this results in high organisational efficiency, i.e. low costs and high returns.

- **Get benefits from Government**: International business brings a lot of foreign exchange for the country. Therefore, it gets many benefits, facilities and concessions from the government. It gets many financial and tax benefits from the government.

- **Expand and diversify**: International business can expand and diversify its activities. This is because it earns very high profits. It also gets financial help from the government.

- **Increase competitive capacity**: International business produces high-quality goods at low cost. It spends a lot of money on advertising all over the world. It uses superior technology, management techniques, marketing techniques, etc. All this makes it more competitive. So, it can fight competition from foreign companies.

- **Economies Of Scale:** These business are able to enjoy economies of scale due to their large scale production. International businesses produce large amount of goods for selling in different countries. With the increase in amount of production, per unit cost of producing goods goes down which helps them in earning large profits.

- **Cost Advantage:** International business takes cost advantage over its competitors by producing goods in one country and exporting them in another country. They carry on their production in a country where factors of production are easily and cheaply available. This helps in minimizing the cost of product and earn huge profits by selling them at better prices in other countries.

- **Provide Employment Opportunities:** International business employs large number of people for carrying out its operations across the globe. They perform large scale operations in many countries for which they require large amount of human resource.

Scope of International Business

- **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.**

- **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.

- **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.

Scope of International Business

- **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.
- **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.
- **Benefiting From Currency Exchange:** International business also plays an important role while the currency exchange rate as one can take advantage of the currency fluctuations.
- **Limitations Of The Domestic Market:** If the domestic market of a country is small then the international business is a good option for the growth of the business in the host country. Depression of domestic market firms will force to explore foreign markets.

What is Globalisation?

- The meaning of Globalisation is usually interpreted to indicate the **integration of the economy of the nation with the world economy**, it is a multifaceted aspect.
- It is a result of the collection of multiple strategies that are directed at transforming the world towards greater interdependence and integration.
- It includes the creation of networks and pursuits transforming social, economic and geographical barriers. Globalisation tries to build links in such a way that the events in India can be determined by events happening distances away.
- In other words, Globalisation is the method of interaction and union among people, corporations and governments universally.

What is Globalisation?

- **Accordingly, the term globalisation has four parameters:**

- Permitting **free flow of goods** by removing or reducing trade barriers between the countries,
- Creating environment for **flow of capital** between the countries,
- Allowing **free flow in technology transfer** and
- Creating environment for **free movement of labour** between the countries of the world.

Thus taking the entire world as global village, all the four components are equally important for attaining a smooth path for globalisation.

FEATURES OF GLOBALIASTION

- Rapid expansion of international trade
- Internationalization of products and services by large firms
- Growing importance of multinational corporations
- Increase in capital transfers across national borders
- Globalization of technology
- Shifts in production from country to country
- Increased freedom and capacity and firms to undertake economic transactions across national boundaries
- Fusing of national markets
- Economic integration
- Global economic interdependence

Advantages of Globalisation

- **The following are some of the important advantages of globalisation for a developing country like India:**

1. Globalisation helps to boost the long run average growth rate of the economy of the country through:

- (a) Improvement in the allocative efficiency of resources;
- (b) Increase in labour productivity; and
- (c) Reduction in capital-output ratio.

2. Globalisation paves the way for removing inefficiency in production system. Prolonged protective scenario in the absence of globalisation makes the production system careless about cost effectiveness which can be attained by following the policy of globalisation.

3. Globalisation attracts **entry of foreign capital along with foreign updated technology which improves the quality of production.**

4. Globalisation usually restructure production and trade pattern favouring labour-intensive goods and labour-intensive techniques as well as expansion of trade in services.

Advantages of Globalisation

5. In a globalized scenario, domestic industries of developing country become conscious about price reduction and quality improvement to their products so as to face foreign competition.

6. Globalisation discourages uneconomic import substitution and favour cheaper imports of capital goods which reduces capital-output ratio in manufacturing industries. Cost effectiveness and price reduction of manufactured commodities will improve the terms of trade in favour of agriculture.

7. Globalisation facilitates consumer goods industries to expand faster to meet growing demand for these consumer goods which would result faster expansion of employment opportunities over a period of time. This would result trickle down effect to reduce the proportion of population living below the poverty line

8. Globalisation enhances the efficiency of the banking insurance and financial sectors with the opening up to those areas to foreign capital, foreign banks and insurance companies

trade

Global trade

- Imports and exports
- Trade with many countries
- Trade agreements help exporters
- More demand for goods and services as living standards improve
- Lower business costs

Global migration

- People moving to other countries
- People working overseas
- International tourism
- Cheaper flights and transport

culture

migration

Global culture

- Products from many countries
- Cultural exchange and understanding
- Cultural exports
- Global advertising
- Global organisations

Global communication

- Cheaper, faster communication
- Internet access
- Global media networks
- New technologies
- Increased awareness of international issues

communication

Why should companies expand internationally?

- A truly multinational company is one which has a globalized supply chain spread across different parts of the world. While a global supply chain has its own vulnerabilities, which are usually beyond the control of the company (for example: the Tsunami in Japan), there are many reasons why a company would want to enter into international markets.

- The primary reasons that companies opt to expand into foreign markets are to:

- **1. 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 that market. This is obviously minus the initial go-to-market cost of breaking into that international market.

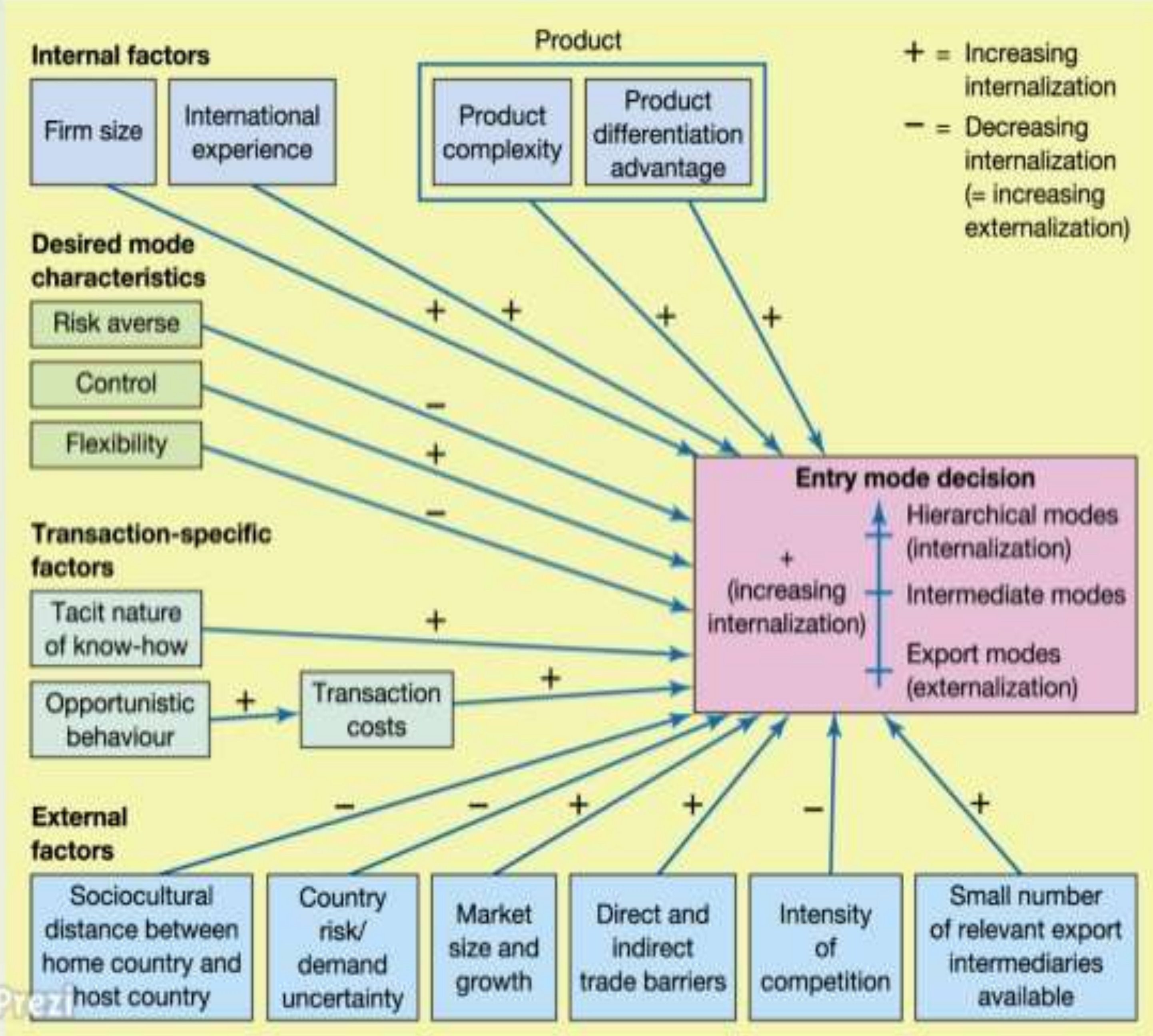
- **2. Achieve economies of scale with a larger customer base:** Some goods and commodities provide the company with great economies of scale opportunities. The effects of economies of scale can be magnified when a larger base of customers come into the business. This is pretty relevant to tech-based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

Why should companies expand internationally?

- **3. 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. Service customers who are abroad:** There could be tech companies who already serve customers around the world despite being centered at 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 relevant market.

Figure 9.1 Factors affecting the foreign market entry mode decision



Factors Affecting the Selection of International Market Entry Mode

- **1) External Factors:**
- **i) Market Size:** Market size of the market is one of the key factors an international marketer has to keep in mind when selecting an entry mode. Countries with a large market size justify the modes of entry with long-term commitment requiring higher level of investment, such as wholly owned subsidiaries or equity participation.
- **ii) Market Growth:** Most of the large, established markets, such as the US, Europe, and Japan, has more or less reached a point of saturation for consumer goods such as automobiles, consumer electronics. Therefore, the growth of markets in these countries is showing a declining trend. Therefore, from the perspective of long-term growth, firms invest more resources in markets with high growth potential.
- **iii) Government Regulations:** The selection of a market entry mode is to a great extent affected by the legislative framework of the overseas market. The governments of most of the Gulf countries have made it mandatory for foreign firms to have a local partner. For example, the UAE is a lucrative market for Indian firms but most firms operate there with a local partner.
- **iv) Level of Competition:** Presence of competitors and their level of involvement in an overseas market is another crucial factor in deciding on an entry mode so as to effectively respond to competitive market forces. This is one of the major reasons behind auto companies setting up their operations in India and other emerging markets so as to effectively respond to global competition.

Factors Affecting the Selection of International Market Entry Mode

- **v) Physical Infrastructure:** The level of development of physical infrastructure such as roads, railways, telecommunications, financial institutions, and marketing channels is a pre-condition for a company to commit more resources to an overseas market. The level of infrastructure development (both physical and institutional) has been responsible for major investments in Singapore, Dubai, and Hong Kong. As a result, these places have developed as international marketing hubs in the Asian region.
- **vi) Level of Risk:**
- **From the point of view of entry mode selection, a firm should evaluate the following risks:**
- **a) Political Risk:** Political instability and turmoil dissuades firms from committing more resources to a market.
- **b) Economic Risk:** Economic risk may arise due to volatility of exchange rates of the target market's currency, upheavals in balance of payments situations that may affect the cost of other inputs for production, and marketing activities in foreign markets. International companies find it difficult to manage their operations in markets wherein the inflation rate is extremely high.
- **c) Operational Risk:** In case the marketing system in an overseas country is similar to that of the firm's home country, the firm has a better understanding of operational problems in the foreign market in question.

Factors Affecting the Selection of International Market Entry Mode

- **2) Internal Factors:**
- **i) Company Objectives:** Companies operating in domestic markets with limited aspirations generally enter foreign markets as a result of a reactive approach to international marketing opportunities. In such cases, companies receive unsolicited orders from acquaintances, firms, and relatives based abroad, and they attempt to fulfill these export orders.
- **ii) Availability of Company Resources:** Venturing into international markets needs substantial commitment of financial and human resources and therefore choice of an entry mode depends upon the financial strength of a firm. It may be observed that Indian firms with good financial strength have entered international markets by way of wholly owned subsidiaries or equity participation.
- **iii) Level of Commitment:** In view of the market potential, the willingness of the company to commit resources in a particular market also determines the entry mode choice. Companies need to evaluate various investment alternatives for allocating scarce resources. However, the commitment of resources in a particular market also depends upon the way the company is willing to perceive and respond to competitive forces.
- **iv) International Experience:** A company well exposed to the dynamics of the international marketing environment would be at ease when making a decision regarding entering into international markets with a highly intensive mode of entry such as Joint ventures and wholly owned subsidiaries.

Modes of Entry into International Business

- There are various ways in which a company can enter into international business.

- **Exporting and Importing:**
- Exporting refers to selling of goods and services by a firm of home country to a firm of foreign country. For example, sale of sweets by Haldiram to WalMart Store in USA.
- Importing refers to buying of goods and services by a firm of home country from a firm of foreign country. For example, purchase of toys by an Indian toy dealer from a Chinese firm.

- **Two Important Ways to Export and Import:**
- Direct Exporting/Importing – The firm deals directly with the overseas buyers or suppliers and carries out all formalities related to shipment and financing of goods and services.
- Indirect Exporting/Importing – The firm employs a middleman (such as export houses or buying offices of overseas customers), who deals with the overseas buyers or suppliers and carries out all the formalities. The firm's participation is minimum.

- **Tangible vs. Intangible Exports and Imports: The exports and imports can be of two types:**

- 1. Merchandise exports and imports – Merchandise means goods that are tangible, i.e., which can be seen and touched. The trade in merchandise is also known as 'Visible Trade'. Merchandise exports involves sending tangible goods abroad, while merchandise imports means bringing tangible goods from a foreign country to the home country.
- 2. Service exports and imports – It involves trade in intangibles, i.e., which cannot be seen and touched. The trade in services is also known as 'Invisible Trade'. It includes trading in wide variety of services, such as tourism, entertainment, transportation, communication, banking, etc.

- **Advantages of Exporting and Importing:**
- 1. Easy Mode – As compared to other modes of international business, it is the easiest way to get entry into international market.
- 2. Less Investment – It does not require heavy investment as needed in case of other modes of entry. Moreover, firm is not required to invest much of its time in business operations.
- 3. Less Risk – It is less risky due to negligible or low foreign investment as compared to other modes of entry.

Advantages of Import and Export

- It is one of the simplest routes of entering into the global trade and import and export generate huge employment opportunities.
- Requires less investment in terms of time and money when contrasted with other methods of entering into the global trade.
- Is comparatively less risky when compared with different routes of entering in international business.
- As no nation can be 100% self-sufficient, import and export are very crucial for the functioning and growth of that nation.
- Can help Countries to access the best technologies available and best products and services in the world.
- It gives better control over the trade than setting up a market and the risk is considerably low.

Contract Manufacturing:

- Contract manufacturing is a type of international business, in which a firm enters into a contract with another firm in foreign country to manufacture certain components or goods as per its specifications. For example, international companies such as Nike, Reebok, Levis, etc. get their products or components produced in the developing countries under contract manufacturing. Contract manufacturing is also known as outsourcing.
- **Contract manufacturing can be done in three ways:**
- Production of certain components to be used in producing final products – For example, giving contract to manufacture car accessories (like door handles, rear mirror) so that they can be used in manufacturing the final product (i.e. car).
- Assembly of components into final products – For example, assembly of processor, mother board, hard disk, RAM, etc. into a computer.
- Manufacture of the complete product – The contract may also be given to manufacture the complete product. For example, companies like Sony, Samsung get most of the products manufactured as per their specifications.

- **Advantages of Contract Manufacturing:**
- Contract manufacturing offers several advantages to both the international company and local producers in the foreign countries.
- 1. No need to set Production Facilities – It allows the international firms to get the goods produced on a large-scale without requiring investment in setting up production facilities.
- 2. Low Investment Risk – The investment risk is almost negligible due to no/ little investment in the foreign countries.
- 3. Lower Cost of Production – It benefits the international company to get the products manufactured or assembled at lower costs. For example, many foreign firms get their goods manufactured in India due to cheap labour.
- 4. Better utilisation of idle capacity – Local producers in foreign countries also gain as contract manufacturing ensures better utilisation of their production capacity. For example, Godrej group has been benefitted by using its excess soap manufacturing capacity in manufacturing Dettol soap for foreign company, Reckitt and Colman.
- 5. Benefits of Export Incentives – The local manufacturers can get benefits of export incentives if the produced goods are to be delivered to a foreign country (as per requirements of the international firm).

- # Licensing and Franchising:

- **Licensing:**
- Licensing is a contractual arrangement in which one firm grants access to its patents, trade secrets or technology to another firm in a foreign country for a fee called royalty. For example, Pepsi and Coca Cola are produced and sold all over the world by local bottlers in foreign countries under the licensing system.
- The firm that grants such permission is known as ‘Licensor’ and the other firm in the foreign country that acquires such rights are known as ‘Licensee’. When there is mutual exchange of knowledge, technology and/or patents between the firms, it is known as ‘Cross-licensing’.
- It may be mentioned here that it is not only technology that is licensed. For example, in the fashion industry, designers license the use of their names.

- **Franchising:**
- Franchising is a contractual agreement which involves grant of rights by one party to another for use of technology, trademark and patents in return of the agreed payment for a certain period of time. The company that grants the rights (i.e. parent company) is known as ‘Franchiser’ and the other company (which acquires the rights) is known as ‘Franchisee’.

- **Why is Franchising so Popular?**
- The franchiser has developed a unique technique for creating and marketing of services under its own name and trade mark. This uniqueness enables the franchiser to have a competitive edge in the market and induces the firms to become their franchisee. For example, McDonald, Pizza Hut and Wal-Mart are some of the leading franchisers operating worldwide.

Franchising vs. Licensing:

- 1. Franchising is used in connection with service business, while licensing is used in connection with production and marketing of goods.
- 2. Franchising is relatively more rigid than licensing, i.e., franchisers usually set strict rules and regulations as compared to licensing.
- Except for these two differences, franchising is pretty much the same as licensing.

- **Examples of Franchising**
- McDonald's
- KFC
- Burger King
- Pizza Hut
- Dunkin Donuts
- Subway
- Taco Bell
- Dominos Pizza
- Baskin-Robbins

Advantages of Franchising and Licensing

- It is a more affordable method of stepping into international business as the licensors or franchisers don't need to pour too many funds abroad.
- The level of risk of the licensor is low because there is zero or next to zero investment is involved.
- Licensee/Franchisee is the individual who is the resident of the same country which limits Government intervention. Thus, business runs without any hurdles.
- The licensee has more market understanding and contacts as he is a local individual which guarantee achievement of marketing goals.
- Excluding Licensee/Franchise, no other foreign organization can utilize such trademarks and licenses.

- # Joint Ventures:
- When two or more firms join together for a common purpose and mutual benefit, it is known as joint venture. For example, joint venture of Hero of India with Honda of Japan. It involves establishing a firm that is jointly owned by two or more otherwise independent firms.
- In India, joint venture is very popular as it not only attracts foreign capital but also foreign technology.

Formation of Joint Venture:

- **A joint venture company can be formed in any of the following ways:**
- 1. A foreign company acquires interest (i.e. portion of equity shares) in an existing Indian company.
- 2. An Indian company acquires interest in an existing foreign firm.
- 3. Both foreign company and Indian company join together to form a new enterprise.

- **Advantages of Joint Venture:**
- 1. Less Financial Burden in Global Expansion – It is financially less burdensome to expand globally for the international firm as local partner also contributes to the equity capital of such venture.
- 2. Facilitates Large-scale Operation – Joint ventures make it possible to operate on large-scale and execute heavy projects, which require huge capital and manpower.
- 3. Benefits of Local Partner's knowledge – The joint venture helps to take advantage of knowledge of local partner regarding the competitive conditions, culture, business and political systems.
- 4. Sharing of Cost and Risks – Generally, business in foreign market is very costly and risky. Joint venture facilitates sharing of such costs and risks with a local partner.

Wholly Owned Subsidiaries:

- A ‘wholly owned subsidiary’ is a company in which 100 per cent investment in its equity capital is made by a parent company.
- The company making the investment is known as ‘Parent Company’ or ‘Holding Company’.
- This mode of entering into international business is preferred by those companies, which want full control over their overseas operations.
- **There are two ways of establishing a wholly owned subsidiary in a foreign market:**

  - Setting up a new company by making 100% investment in a foreign country. It is also referred to as a Green Field Venture.
  - Acquiring an established company by investing 100% in its equity in a foreign country and using that firm to manufacture and/or promote its product in the host country.

- A company becomes the holding company when it acquires more than 50% equity shares in another company (known as subsidiary company). However, if the holding company holds 100% equity shares in a company, then the latter is termed as ‘wholly-owned subsidiary company’.

Advantages of Wholly Owned Subsidiaries:

- **The major advantages of a wholly owned subsidiary in a foreign country are as follows:**

- 1. Full Control – The parent company is able to exercise full control over the management of wholly owned subsidiary company in the foreign country.

- 2. No Disclosure of Trade Secrets – As the parent company has full control over operations of foreign subsidiary, it prevents leakage of technology or trade secrets to others.

The Benefits of International Business and the Concept of Comparative Advantage

- Participation in international business allows countries to take advantage of their *comparative advantage.*
- The concept of comparative advantage means that a nation has an advantage over other nations in terms of access to affordable land, resources, labor, and capital.
- In other words, a country will export those products or services that utilize abundant factors of production. Further, companies with sufficient capital may seek another country that is abundant in land or labor, or companies may seek to invest internationally when their home market becomes saturated.
- Participation in international business allows countries to take advantage of specialized expertise and abundant factors of production to deliver goods and services into the international marketplace. This has the benefit of increasing the variety of goods and services available in the marketplace.
- International business also increases competition in domestic markets and introduces new opportunities to foreign markets. Global competition encourages companies to become more innovative and efficient in their use of resources.
- For consumers, international business introduces them to a variety of goods and services. For many, it enhances their standard of living and increases their exposure to new ideas, devices, products, services, and technologies.

Why Expand Globally?

- Global expansion is costly and complex. To offset these costs and risks, organizations must have strong reasons for **developing a global strategy**. These reasons generally fit one (or more) of the following three strategic areas:
- **Global Concentration** – Depending upon the competitive concentration of a given industry in a given region, it may make sense **to enter a market where competition is relatively scarce (and demand is high).**
- **Global Synergies** – Some organizations have **highly developed competencies** that are easily scaled. In these situations, global expansion means **natural synergy.**
- **Global Strategic Motivations** – Other reasons for expansion to a given country may exist strategically, such as **developing new sourcing sites for production or acquiring strategic assets in a given region.**

External Factors Impacting Expansion

International expansion can be a costly and complex procedure. Before considering such a significant strategic move, management must weigh the external factors that will impact success during a global transition. These include:

- Socio-cultural: The social environment of a given region can have a significant impact on success. Food companies are highly impacted by this – certain cultures prefer certain types of foods.
- Geographic/Environmental – For example, skiing equipment may not do so well in regions without snow or mountains. Oil companies can only source oil from resource-rich regions.
- Legal/Political – Some countries have high barriers to entry, complex tax rates, and/or unclear legislative practices. Ease of doing business is critical here.
- Economic – The standard of living is different from region to region, and recognizing the value of a given market in terms of spending power, currency, and market size is critical to deciding upon expansion.
- Technology – Access to internet, electricity, clean water and a variety of other technological dependencies must be considered prior to entry if the organizational operations rely on easy access.

- Weighing the pros and cons of entering a given reason, and calculating projected cash flows, costs, and required returns on investment are central financial considerations to entering a new international market.

International Business Environment

- The (IBE) International Business Environment is **multidimensional including the political risks, cultural differences, exchange risks, legal & taxation issues.** Therefore, (IBE) **International Business Environment** comprises the political, economic, regulatory, tax, social & cultural, legal, & technological environments.
- **An international business environment is the surrounding in which international companies run their businesses.**
- Thus, it is mandatory for the people at the managerial level to work on the factors that make an International Business Environment.
- International business is an exchange of goods and services that conducts its operations across national borders, between two or more countries. International business is also known as Globalization whereas, a Business Environment is the surrounding in which the international companies operate.

Advantages of International Business Environment

- Helps in expanding the business,
- Exposure to more customers
- Helps in the proper management of the product life cycle and
- Helps in mutual growth

Political Environment

- The political environment refers to the **type of the government, the government relationship with a business, & the political risk in the country.** Doing business internationally, therefore, implies dealing with a different type of government, relationships, & levels of risk.
- There are many different types of political systems, **for example**, multi-party democracies, one-party states, constitutional monarchies, dictatorships (military & non-military). Therefore, in analyzing the political-legal environment, an organization may broadly consider the following aspects:
- The Political system of the business;
- Approaches to the Government towards business i.e. Restrictive or facilitating;
- Facilities & incentives offered by the Government;
- Legal restrictions for instance licensing requirement, reservation to a specific sector like the public sector, private or small-scale sector;
- The Restrictions on importing technical know-how, capital goods & raw materials;
- The Restrictions on exporting products & services;
- Restrictions on pricing & distribution of goods;
- Procedural formalities required in setting the business

Economic Environment

- The economic environment relates to all the factors that contribute to a country's attractiveness for foreign businesses.
- The economic environment can be very different from one nation to another. Countries are often divided into three main categories: **the more developed or industrialized**, the **less developed** or third world, & **the newly industrializing or emerging economies**.
- Within each category, there are major variations, but overall the more developed countries are the rich countries, the less developed the poor ones, & the newly industrializing (those moving from poorer to richer).
- These distinctions are generally made on the basis of the gross domestic product per capita (GDP/capita). Better education, infrastructure, & technology, healthcare, & so on are also often associated with higher levels of economic development.

Economic Environment

- Clearly, the level of economic activity combined with education, infrastructure, & so on, as well as the degree of government control of the economy, affect virtually all facets of doing business, & a firm needs to recognize this environment if it is to operate successfully internationally. While analyzing the economic environment, the organization intending to enter a particular business sector may consider the following aspects:
- An Economic system to enter the business sector.
- Stage of economic growth & the pace of growth.
- Level of national & per capita income.
- Incidents of taxes, **both direct & indirect tax.**
- Infrastructure facilities available & the difficulties thereof.
- Availability of raw materials & components & the cost thereof.
- Sources of financial resources & their costs.
- Availability of manpower-managerial, technical & workers available & their salary & wage structures.

Technological Environment

- The technological environment comprises factors related to the materials & machines used in manufacturing goods & services.
- Receptivity of organizations to new technology & adoption of new technology by consumers influence decisions made in an organization.
- As firms do not have any control over the external environment, their success depends on how well they adapt to the external environment.
- An important aspect of the international business environment is the level, & acceptance, of technological innovation in different countries.

Technological Environment

- Technology often is seen as giving firms a competitive advantage; hence, firms compete for access to the newest in technology, & international firms transfer technology to be globally competitive.
- In analyzing the technological environment, the organization may consider the following aspects:
- Level of technological development in the country as a whole & specific business sector.
- The pace of technological changes & technological obsolescence.
- Sources of technology.
- Restrictions & facilities for technology transfer & time taken for the absorption of technology.

Cultural Environment

- The cultural environment is one of the critical components of the international business environment This is because the cultural environment is essentially unseen; it has been described as a shared, commonly held body of general beliefs & values that determine what is right for one group,
- National culture is described as the body of general beliefs & the values that are shared by the nation. Beliefs & the values are generally seen as formed by factors such as the history, language, religion, geographic location, government, & education; thus firms begin a cultural analysis by seeking to understand these factors. The most well-known is that developed by Hofstede in1980.
- His model proposes four dimensions of cultural values including individualism, uncertainty avoidance, power distance & masculinity.
- Individualism is the degree to which a nation values & encourages individual action & decision making.
- Uncertainty avoidance is the degree to which a nation is willing to accept & deal with uncertainty.
- Power distance is the degree to which a national accepts & sanctions differences in power.
- Masculinity comes with the distinct gender roles, assertive, and concentrated on material achievements and wealth-building.

Cultural Environment

- This model of cultural values has been used extensively because it provides data for a wide array of countries. Many academics & the managers found that this model helpful in exploring management approaches that would be appropriate in different cultures.
- **For example,** in a nation that is high on individualism one expects individual goals, individual tasks, & individual reward systems to be effective, whereas the reverse would be the case in a nation that is low on individualism.
- While analyzing social & cultural factors, the organization may consider the following aspects:
- Approaches to society towards business in general & in specific areas;
- Influence of social, cultural & religious factors on the acceptability of the product;
- The lifestyle of people & the products used for them;
- Level of acceptance of, or resistance to change;
- Values attached to a particular product i.e. the possessive value or the functional value of the product;
- Demand for the specific products for specific occasions;
- The propensity to consume & to save.

Balance of Payment and Balance of Trade INTRODUCTION

- A country's balance of payments (BoP) is defined as the summary of all its economic transactions that have taken place between the country's residents and the residents of other countries during a specified time period.
- It is used as an indicator of a country's political and economic stability.
- It is a statistical record of the character and dimensions of the country's economic relationships with the rest of the world.
- The balance of payments is merely a way of listing receipts and payments in international transactions for a country.
- B. J. Cohen says, "It shows the country's trading position, changes in its net position as foreign lender or borrower, and changes in its official reserve holding."
- A consistently positive BoP reflects more foreign investment and money coming into the country and not much of its currency being exported.
- On the other hand, adverse or negative BoP indicates more outflows of money compared to inflows.

Balance of Payment

- The balance of payment is generally computed on a monthly, quarterly, or yearly basis.
- The balance of payments includes both visible and invisible transactions.
- The balance of payments reports the country's international performance in trading with other nations and the volume of capital flowing in and out of the country.
- Balance of payments accounting uses the system of double-entry bookkeeping, which means that every debit or credit in the account is also represented as a credit or debit somewhere else.
- In a balance-of-payment sheet, currency inflows are recorded as credits (plus sign), whereas outflows are recorded as debits (minus sign).

Structure of Balance of Payments Accounts

- The balance of payments account of a country is constructed on the principle of double-entry bookkeeping.
- Each transaction is entered on the credit and debit side of the balance sheet.
- But balance of payments accounting differs from business accounting in one respect.
- In business accounting, debits (-) are shown on the left side and credits (+) on the right side of the balance sheet.
- But in balance of payments accounting, the practice is to show credits on the left side and debits on the right side of the balance sheet.
- When a **payment is received from a foreign country**, it is a **credit transaction** while **payment to a foreign country is a debit transaction**.

Structure of Balance of Payments Accounts

- The principal items shown on the **credit side (+)** are **exports of goods and services, unrequited (or transfer) receipts in the form of gifts, grants, etc. from foreigners, borrowings from abroad, investments by foreigners in the country, and official sale of reserve assets including gold to foreign countries and international agencies.**
- The principal items on the **Debit side (-)** include **imports of goods and services, transfer (or unrequited) payments to foreigners as gifts, grants, etc., lending to foreign countries, investments by residents to foreign countries, and official purchase of reserve assets or gold from foreign countries and international agencies.**
- These credit and debit items are **shown vertically in the balance of payments account of a country according to the principle of double-entry book-keeping.**

Horizontally, they are divided into three categories

- The current account, the capital account, and the official settlements account or the Official reserve assets account.

Table 1. Balance of Payments Account

Credits (+) (Receipts)	Debits (–) (Payments)
1. Current Account	
Exports	*Imports*
(a) Goods	(a) Goods
(b) Services	(b) Services
(c) Transfer Payments	(c) Transfer Payments
2. Capital Account	
(a) Borrowings from Foreign Countries	(a) Lending to Foreign Countries
(b) Direct Investments by Foreign Countries	(b) Direct Investments in Foreign Countries
3. Official Settlements Account	
(a) Increase in Foreign Official Holdings	(a) Increase in Official Reserve of Gold and Foreign Currencies
Errors and Omissions	

Current Account

- Current account refers to an account which records all the transactions relating to export and import of goods and services and unilateral transfers during a given period of time.
- Current account contains the receipts and payments relating to all the transactions of visible items, invisible items and unilateral transfers.
- The current account of a country consists of all transactions relating to trade in goods and services and unilateral (or unrequited) transfers.
- Service transactions include costs of travel and transportation, insurance, income and payments of foreign investments, etc.
- Transfer payments relate to gifts, foreign aid, pensions, and private remittances, charitable donations etc. received from foreign individuals and governments to foreigners.
- In the current account, merchandise exports and imports are the most important items. Exports are shown as a positive item and are calculated f.o.b. (free on board) which means that costs of transportation, insurance, etc are excluded.
- On the other side, imports are shown as a negative item and are calculated c.i.f. which means that costs, insurance and freight are included.
- The difference between exports and imports of a country is its balance of visible trade or merchandise trade or simply balance of trade. If visible exports exceed visible imports, the balance of trade is favourable. In the opposite case when imports exceed exports, it is unfavourable.

Components of Current Account

- **The main components of Current Account are:**
- **1. Export and Import of Goods (Merchandise Transactions or Visible Trade):**
- A major part of transactions in foreign trade is in the form of export and import of goods (visible items). Payment for import of goods is written on the negative side (debit items) and receipt from exports is shown on the positive side (credit items). Balance of these visible exports and imports is known as balance of trade (or trade balance).
- **2. Export and Import of Services (Invisible Trade):**
- It includes a large variety of non- factor services (known as invisible items) sold and purchased by the residents of a country, to and from the rest of the world. Payments are either received or made to the other countries for use of these services.
- **Services are generally of three kinds:**
- (a) Shipping,
- (b) Banking, and
- (c) Insurance.
- Payments for these services are recorded on the negative side and receipts on the positive side.

Components of Current Account

- **The main components of Current Account are:**
- **3. Unilateral Transfers to and from abroad (One sided Transactions):**
- Unilateral transfers include gifts, donations, personal remittances and other ‘one-way’ transactions.
- These refer to those receipts and payments, which take place without any service in return.
- Receipt of unilateral transfers from rest of the world is shown on the credit side and unilateral transfers to rest of the world on the debit side.
- **4. Income receipts and payments to and from abroad:**
- It includes investment income in the form of interest, rent and profits.

Current Account

- In the current account, receipts from export of goods, services and unilateral receipts are entered as credit or positive items and payments for import of goods, services and unilateral payments are entered as debit or negative items.
- The net value of credit and debit balances is the balance on current account.
- 1. Surplus in current account arises when credit items are more than debit items. It indicates net inflow of foreign exchange.
- 2. Deficit in current account arises when debit items are more than credit items. It indicates net outflow of foreign exchange.

Capital Account

- Capital account of BOP records all those transactions, between the residents of a country and the rest of the world, which cause a change in the assets or liabilities of the residents of the country or its government.
- It is related to claims and liabilities of financial nature.
- **Capital Account is used to:**
- **(i) Finance deficit in current account; or**
- **(ii) Absorb surplus of current account.**
- Capital account is concerned with financial transfers. So, it does not have direct effect on income, output and employment of the country.

Components of Capital Account

- **1. Borrowings and lending to and from abroad: It includes:**
- A. All transactions relating to borrowings from abroad by private sector, government, etc. Receipts of such loans and repayment of loans by foreigners are recorded on the positive (credit) side.
- B. All transactions of lending to abroad by private sector and government. Lending abroad and repayment of loans to abroad is recorded as negative or debit item.
- **2. Investments to and from abroad: It includes:**
- A. Investments by rest of the world in shares of Indian companies, real estate in India, etc. Such investments from abroad are recorded on the positive (credit) side as they bring in foreign exchange.
- B. Investments by Indian residents in shares of foreign companies, real estate abroad, etc. Such investments to abroad be recorded on the negative (debit) side as they lead to outflow of foreign exchange.

Components of Capital Account

- **3. Change in Foreign Exchange Reserves:**
- The foreign exchange reserves are the financial assets of the government held in the central bank.
- A change in reserves serves as the financing item in India’s BOP. So, any withdrawal from the reserves is recorded on the positive (credit) side and any addition to these reserves is recorded on the negative (debit) side.
- It must be noted that ‘change in reserves’ is recorded in the BOP account and not ‘reserves’.

Capital Account

- The transactions, which lead to inflow of foreign exchange (like receipt of loan from abroad, sale of assets or shares in foreign countries, etc.), are recorded on the credit or positive side of capital account.
- Similarly, transactions, which lead to outflow of foreign exchange (like repayment of loans, purchase of assets or shares in foreign countries, etc.), are recorded on the debit or negative side.
- The net value of credit and debit balances is the balance on capital account.
- **A. Surplus in capital account arises when credit items are more than debit items. It indicates net inflow of capital.**
- **B. Deficit in capital account arises when debit items are more than credit items. It indicates net outflow of capital.**

The official settlements account

- The official settlements account or official reserve assets account is, in fact, a part of the capital account. But the U.K. and U.S. balance of payments accounts show it as a separate account.
- "The official settlements account measures the change in nation's liquidity and non-liquid liabilities to foreign official holders and the change in a nation's official reserve assets during the year.
- The official reserve assets of a country include its gold stock, holdings of its convertible foreign currencies and SDRs, and its net position in the IMF."
- It shows transactions in a country's net official reserve assets.

OFFICIAL RESERVE ACCOUNT

- The surplus of capital and current account are transffered to ORA.
- ORA can be used where there occurs future deficit.
- Only reserve assets are included.
- Reserve assets are those assets which the monetary authority of a country used to settle the trade , the surplus or deficit that arise on the capital and current account.
- Includes:

  - The cash balance in Central Bank

  - Gold

  - Reserve in IMF

- **Errors and Omissions:** Errors and omissions is a balancing item so that total credits and debits of the three accounts must equal in accordance with the principles of double entry book-keeping so that the balance of payments of a country always balances in the accounting sense.

- Balance of payments always balances means that the algebraic sum of the net credit and debit balances of current account, capital account and official settlements account must equal zero. Balance of payments is written as.

  - **$B = R_f - P_f$**
    - B =where, B represents balance of payments,
      - R_f receipts from foreigners,
      - P_f payments made to foreigners.

- **When $B = R_f - P_f = 0$, the balance of payments is in equilibrium.**
- **When $R_f - R_f > 0$, it implies receipts from foreigners exceed payments made to foreigners and there is surplus in the balance of payments.**
- **On the other hand, when $R_f - P_f < 0$ or $R_f < P_f$ – there is deficit in the balance of payments as the payments made to foreigners exceed receipts from foreigners.**
- If net foreign lending and investment abroad are taken, a flexible exchange rate creates an excess of exports over imports. The domestic currency depreciates in terms of other currencies.

The Difference Between

BALANCE OF PAYMENTS DEFICIT

- The country imports more goods, services & capital than it exports.
- It must borrow from other countries to pay for its imports.
- In the short-term, this fuels economic growth.
- In the long-term, it will have to go into debt to pay for consumption.

BALANCE OF PAYMENTS SURPLUS

- The country exports more than it imports.
- Country provides enough capital to pay for all domestic production.
- A surplus boosts economic growth in the short term.
- In the long run, it becomes too dependent on export-driven growth.

THE BALANCE OF TRADE (BOT)

- The balance of trade (BOT), also known as the trade balance, refers to the difference between the monetary value of a country’s imports and exports over a given time period.
- A positive trade balance indicates a trade surplus while a negative trade balance indicates a trade deficit.
- The BOT is an important component in determining a country’s current account.
- The balance of trade is the value of a country's exports minus its imports.
- It is the biggest component of the balance of payments that measures all international transactions. It's easy to measure since all goods and many services pass through the customs office.
- The trade balance is also the biggest part of the current account. It measures a country's net income earned on international assets. It's the trade balance plus any other payments across borders.

Features of Balance of Trade

- **Various features of balance of trade have been explained below:**
- **1. Exports and Imports:** The elements of the balance of trade are exports and imports. Export of goods means movement of goods from domestic country to foreign country. The vis-a-vis is known as Imports.
- **2. Visible Goods:** Balance of trade constitutes imports and exports of goods. The important features of the goods are that it must be visible, have physical structure, size, shape and form. The goods must be seen and touched, counted, measured and weighed.
- **3. Material Goods:** Goods constitute our imports and exports must be material. It means that non- material goods and services will not constitute imports and exports.

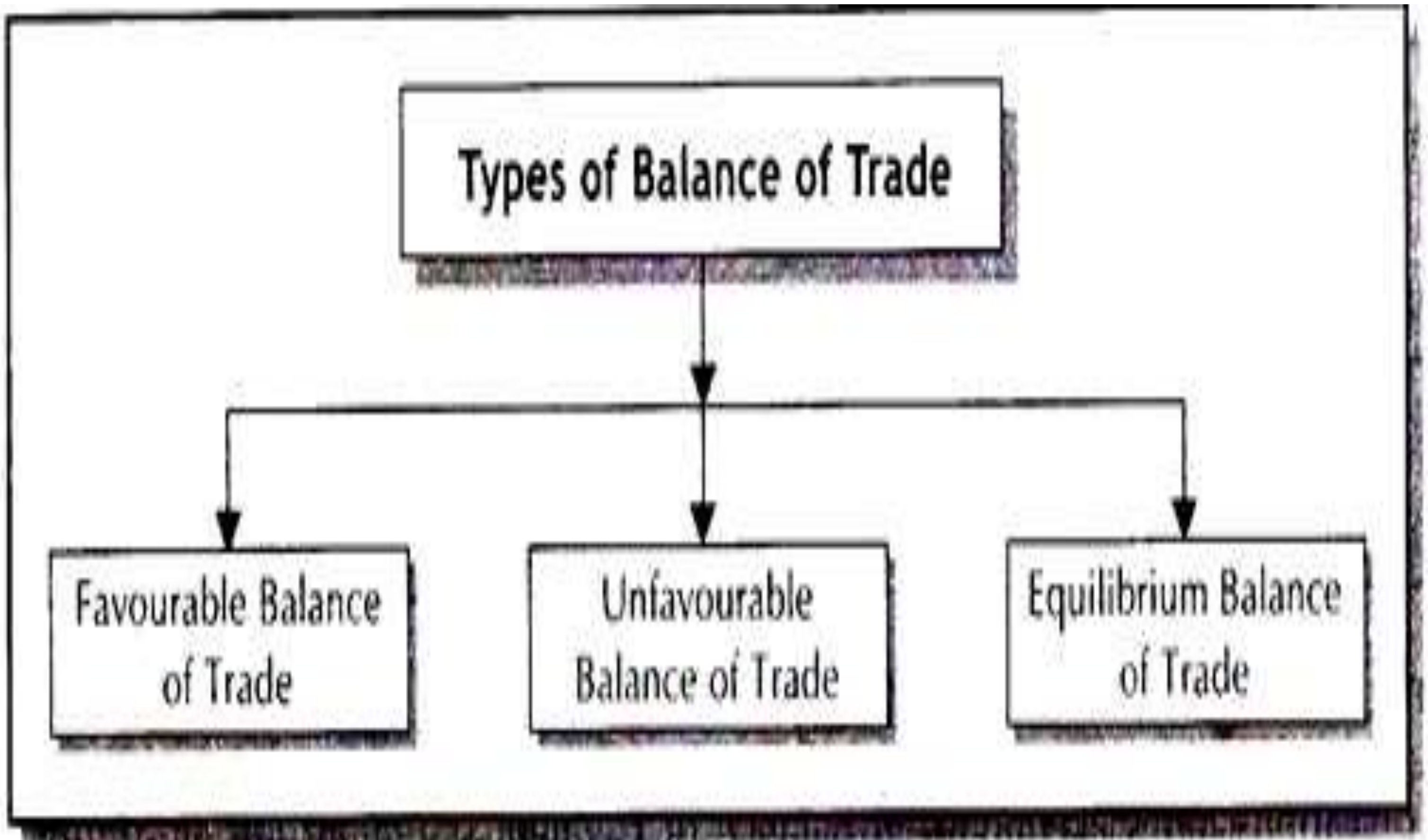


Figure 2.2: Various Types of Balance of Trade

Types of Balance of Trade

- **1. Favourable Balance of Trade: The situation, wherein country's exports exceed imports is a situation of favourable or surplus balance of trade.**

Favourable Balance of Trade = Exports of Goods > Imports of Goods

- **2. Unfavourable/Deficit Balance of Trade: Excess of total value of goods, imported over the total value of goods exported is termed as unfavourable or adverse or deficit balance of trade.**

Unfavourable Balance of Trade = Exports of Goods < Imports of Goods

- **3. Equilibrium in Balance of Trade: Equality between the total value of goods exported and total value of goods imported is termed as equilibrium in balance of trade.**

Equilibrium Balance of Trade = Exports of Goods = Imports of Goods

How to Calculate It

- A country's trade balance equals the value of its exports minus its imports.
  - **The formula is X - M = TB, where:**
    - **X = Exports**
    - **M = Imports**
    - **TB = Trade Balance**
- Exports are goods or services made domestically and sold to a foreigner. That includes a pair of jeans you mail to a friend overseas. It could also be signage a corporate headquarter transfers to its foreign office. If the foreigner pays for it, then it's an export.
- Imports are goods and services bought by a country's residents but made in a foreign country. It includes souvenirs purchased by tourists traveling abroad. Services provided while traveling, such as transportation, hotels, and meals, are also imports. It doesn't matter whether the company that makes the good or service is a domestic or foreign company. If it was purchased or made in a foreign country, it's an import.
- **When a country's exports are greater than its imports, it has a trade surplus.** Most nations prefer this favorable trade balance.
- **When exports are less than imports, it creates a trade deficit.** Most countries try to avoid such an unfavorable trade balance.
- Sometimes a favorable trade balance, or surplus, is not in the country's best interests. For example, an emerging market should import to invest in its infrastructure. It can run a deficit for a short period with this goal in mind.

Difference Between Balance of Payments and Balance of Trade

Nature	Balance of Payment	Balance of Trade
1. Meaning	It is a systematic record of all economic transactions happened between the resident of one country and resident of foreign countries during a particular period.	Balance of trade is statement showing the net effect of export and import of a country
2. Nature of Transactions recorded	It records both the transactions relating to goods and services	It records only transactions relating to merchandise , i.e. goods transactions
3. Capital Transactions	It records capital transactions	It does not record capital transactions
4. Structure	It includes balance of trade. balance of services, balance of unilateral transfer and balance of capital transactions	It is part of current account of BOP
5. Net Position	It always remains balanced in the sense that receipt side is made equal to payment side	It may be at favorable or unfavourable or in equilibrium state.
6. Indicator Economic Status	It is true indicator of economic performance of an economy	It is not true indicator of economic prosperity or economic relations of country.
7. Correcting Unfavourableness	Unfavourable balance of payment leads to deficit in balance of payment situation.	Unfavourable balance of trade can be converted into favorable balance of payment

Causes of Disequilibrium in the Balance of Payments

- There are several variables which join together to constitute equilibrium in the balance of payments position of a country, viz., national income at home and abroad, the prices of goods and factors, the supply of money, the rate of interest, etc., all of which determine the exports, imports and demand and supply of foreign currency.
- At the back of these variables lie the supply factors, production functions, the state of technology, tastes, the distribution of income, the state of anticipations, etc. If there is a change in any of these variables and there are no appropriate changes in other variables, disequilibrium will be the result.
- The main cause of the disequilibrium in the balance of payments arises from imbalance between exports and imports of goods and services.
- When for one reason or another exports of goods and services of a country are smaller than their imports, disequilibrium in the balance of payments is the likely result.

Causes of Disequilibrium in the Balance of Payments

- Exports may be small due to the lack of exportable surplus which in turn result from low production or the exports may be small because of the high costs and prices of exportable goods and severe competition in the world markets.
- An important cause of small exports is the inflation or rising prices in the country.
- When the prices of goods are high in the country, its exports are discouraged and imports encouraged.
- If it is not matched by other items in the balance of payments, disequilibrium emerges.

Types of disequilibrium in the balance of payments

- **Cyclical Disequilibrium:** Cyclical disequilibrium is caused by the fluctuations in the economic activity or what are known as trade cycles. During the periods of prosperity, prices of goods fall and incomes of the people go down. These changes in incomes of the people and prices of goods affect exports and imports of goods and thereby influence the balance of payments.
- **Cyclical disequilibrium in the balance of payments may occur because:**
- i. Trade cycles follow different paths and patterns in different countries. There are no identical timings and periodicity of occurrence of cycles in different countries.
- ii. No identical stabilisation programmes and measures are adopted by different countries.
- iii. Income elasticities of demand for imports in different countries are not identical.
- iv. Price elasticities of demand for imports differ in different countries.

Types of disequilibrium in the balance of payments

- **ii. Structural Disequilibrium:** It emerges on account of structural changes occurring in some sectors of the economy at home or abroad which may alter the demand or supply relations of exports or imports or both. Suppose the foreign demand for India's jute products declines because of some substitutes, then the resources employed by India in the production of jute goods will have to be shifted to some other commodities of export.
- Moreover, a shift in demand occurs with the changes in tastes, fashions, habits, income, economic progress, etc. Propensity to import may change as a result. Demand for some imported goods may increase, while that for certain goods may decline leading to a structural change.

Types of disequilibrium in the balance of payments

- **iii. Short-run Disequilibrium:** A short-run disequilibrium in a country's balance of payments will be a temporary one, 'lasting for a short period, which may occur once in a while.
- When a country borrows or lends internationally, it will have short-run disequilibrium in its balance of payments, as these loans are usually for a short period or even if they are for a long duration, they are repayable later on; hence the position will be automatically corrected and poses no serious problem.
- As such, a disequilibrium arising from international lending and borrowing activities is perfectly justified. However, a short-run disequilibrium may also emerge if a country's imports exceed its exports in a given year.

Types of disequilibrium in the balance of payments

- **iv. Long-run Disequilibrium:** The long-term disequilibrium thus refers to a deep- rooted, persistent deficit or surplus in the balance of payments of a country.
- It is secular disequilibrium emerging on account of the chronologically accumulated short-term disequilibria — deficits or surpluses.
- It endangers the exchange stability of the country concerned.
- Especially, a long-term deficit in the balance of payments of a country tends to deplete its foreign exchange reserves and the country may also not be able to raise any more loans from foreigners during such a period of persistent deficits.

Disequilibrium

- Debit exceeds Credit or Credit exceeds Debit causing an imbalance in the BOP a/c
- Deficit: Our Receipts from foreigners fall below our payment to foreigners. (Unfavourable)
- Surplus: Receipts exceeds its Payment (Favourable)

Causes

- **Economic Factors**
  - Imbalance between export & Import
  - New Source of supply & new substitutes
  - High Domestic Price
- **Political Factors**
  - Instability & Disturbance cause large capital outflow.
- **Social Factors**
  - Population Growth
  - Change in fashion

STEPS TO CORRECT BOP DEFICIT

Monetary measures
Non – monetary measures

I. Monetary measures.
- Deflation
- Devaluation of currency
- Exchange control
- Increase in Direct and Indirect Tax

II. Non Monetary measures
- 1.Export promotion
- 2. Import substitution
- 3.Quota

Monetary Measures for Correcting the BoP Disequilibrium

- **1. Deflation:** Deflation means **falling prices.** Deflation has been used as a measure to correct deficit disequilibrium. A country faces deficit when its imports exceeds exports.
- **Deflation is brought through** monetary measures like **bank rate policy, open market operations, etc or through fiscal measures like higher taxation, reduction in public expenditure, etc.**
- Deflation would make our items cheaper in foreign market resulting a rise in our exports.
- At the same time the demands for imports fall due to higher taxation and reduced income.
- This would built a favourable atmosphere in the balance of payment position. However Deflation can be successful when the exchange rate remains fixed.

Monetary Measures for Correcting the BoP Disequilibrium

- **2. Exchange Depreciation** Exchange depreciation means **decline in the rate of exchange of domestic currency in terms of foreign currency.** This device implies that a country has adopted a flexible exchange rate policy.
- Suppose the rate of exchange between Indian rupee and US dollar is $1 = Rs. 40. If India experiences an adverse balance of payments with regard to U.S.A, the Indian demand for US dollar will rise. The price of dollar in terms of rupee will rise. Hence, dollar will appreciate in external value and rupee will depreciate in external value. The new rate of exchange may be say $1 = Rs. 50. This means 25% exchange depreciation of the Indian currency.
- **Exchange depreciation will stimulate exports and reduce imports because exports will become cheaper and imports costlier.** Hence, a favourable balance of payments would emerge to pay off the deficit.

Monetary Measures for Correcting the BoP Disequilibrium

- **3. Devaluation:** Devaluation refers to **deliberate attempt made by monetary authorities to bring down the value of home currency against foreign currency.**
- While depreciation is a spontaneous fall due to interactions of market forces, **devaluation is official act enforced by the monetary authority.**
- Generally the **international monetary fund advocates the policy of devaluation as a corrective measure of disequilibrium for the countries facing adverse balance of payment position.**
- When India's balance of payment worsened in 1991, IMF suggested devaluation. Accordingly, the value of Indian currency has been reduced by 18 to 20% in terms of various currencies. The 1991 devaluation brought the desired effect. The very next year the import declined while exports picked up.

Monetary Measures for Correcting the BoP Disequilibrium

- **4. Exchange Control:** It is an extreme step taken by the monetary authority to enjoy complete control over the exchange dealings.
- Under such a measure, **the central bank directs all exporters to surrender their foreign exchange to the central authority.**
- Thus **it leads to concentration of exchange reserves in the hands of central authority.**
- At the same time, the supply of foreign exchange is restricted only for essential goods.
- It can only help controlling situation from turning worse. In short it is only a temporary measure and not permanent remedy.
- **An increase in direct taxes such as income tax will reduce aggregate expenditure. A part of reduction in expenditure may lead to decrease in imports. Increase in indirect taxes such as excise duties and sales tax will also cause reduction in expenditure.**

Non- Monetary Measures for Correcting the BoP Disequilibrium

- A deficit country along with Monetary measures may adopt the following non-monetary measures too which will either restrict imports or promote exports.
- **1. Tariffs:** Tariffs are duties (taxes) imposed on imports. When tariffs are imposed, the prices of imports would increase to the extent of tariff. The increased prices will reduced the demand for imported goods and at the same time induce domestic producers to produce more of import substitutes. Non-essential imports can be drastically reduced by imposing a very high rate of tariff.
- **2. Quotas:** Under the quota system, t**he government may fix and permit the maximum quantity or value of a commodity to be imported during a given period.** By restricting imports through the quota system, the deficit is reduced and the balance of payments position is improved.
- **Types of Quotas** :-
- the tariff or custom quota,
- the unilateral quota,
- the bilateral quota,
- the mixing quota, and
- import licensing.

Non- Monetary Measures for Correcting the BoP Disequilibrium

- **3. Export Promotion:** The government can adopt export promotion measures to correct disequilibrium in the balance of payments. This includes **substitutes, tax concessions to exporters, marketing facilities, credit and incentives to exporters, etc**.
- The government may also help to promote export through **exhibition, trade fairs; conducting marketing research & by providing the required administrative and diplomatic help** to tap the potential markets.

4. Import Substitution: A country may resort to import substitution to reduce the volume of imports and make it self-reliant. Fiscal and monetary measures may be adopted to encourage industries producing import substitutes. Industries which produce import substitutes require special attention in the form of various concessions, which include tax concession, technical assistance, subsidies, providing scarce inputs, etc.

- Non-monetary methods are more effective than monetary methods and are normally applicable in correcting an adverse balance of payments.

What Does Internationalization Mean?

- Internationalization, in brief, is the process where a local enterprise or market produces its products and services in a way that they fit into the needs and wants of other countries as well. Hence, these services and products can be easily used and adapted by those in other countries.
- Internationalization, in other words, is the process of increasing the involvement of a particular enterprise of a company in international markets.
- For this to happen, that particular local market should design a product or a service in such a way that it will meet the needs of users in many countries with minimum cost and efforts.
- And, this may include activities such as sourcing, producing and selling materials, components, goods, and services, etc.

What Does Internationalization Mean?

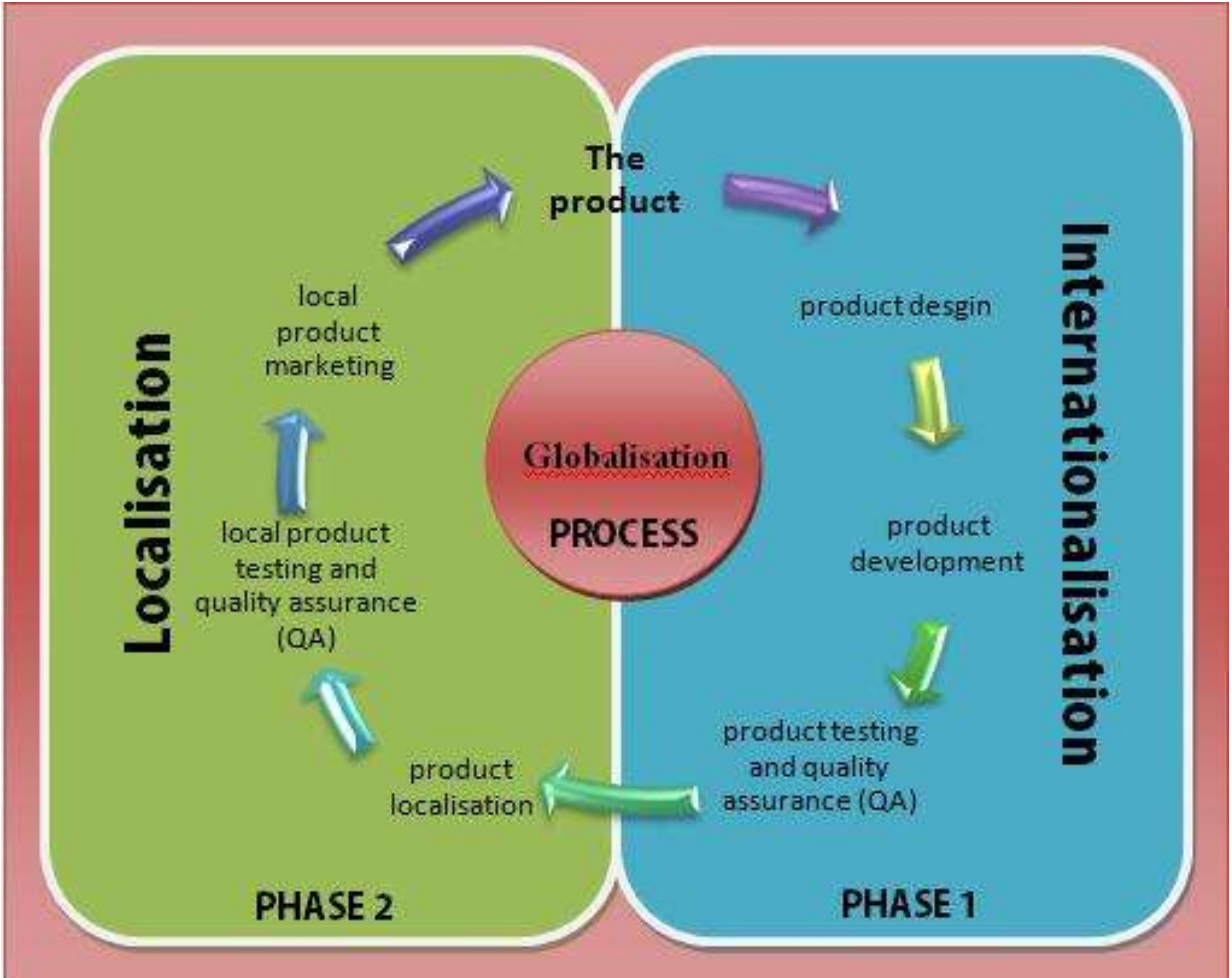
- Using a brand name which can be understood by anyone in any culture and country, using a language which is internationally recognized or enabling the option of translation to fit into the client's local language (with regard to websites, etc.) etc. are several strategies local markets and companies use in internationalization.
- Internationalization is the effort of local markets and business companies to do business in one or more foreign markets.
- Consequently, with the increase of the client base of a certain local market in the international market, they will start creating connections with other international markets as well; this is the aspect of globalization.

What Does Internationalization Mean?

- Accordingly, internationalization means the increase or the expansion of the services and trade among other nations or actors in the international stage.
- Thus, this refers to the expansion of sectors such as international trade, international relations, treaties, diplomatic activities, etc.
- Overall, internationalization results in the expansion of relationships in terms of economics, politics, and trade among the different nations in the world. In a general sense, it is also possible to use the concept of internationalization to other sectors such as education and human rights as well.

What Does Globalization Mean

- Globalization refers to the worldwide interaction or the interconnection of local private and public markets in one global arena, respecting universally accepted rules and regulations.
- This integration of economic, financial, cultural etc. aspects allows the ease of cross-border movement and transfer of people, capital, data, goods, and services.
- Globalization results in the emergence of open markets, free trade economies through non-tariff trade borders, reduction of traffic, development of infrastructure and transportation.
- The business-related strategies span into the cultural aspect of other countries and communities, enabling to create a new assimilated culture.
- Therefore, globalization impacts not only the economy of a certain country, but also the other sectors such as politics, society, culture.
- Hence, globalization can be identified as composed of internationalization and localization.


The product
product desgin
product development
product testing and quality assurance (QA)
product localisation
local product testing and quality assurance (QA)
local product marketing
Globalisation
PROCESS
Localisation
Internationalisation
PHASE 2
PHASE 1

Difference Between Internationalization and Globalization

- Definition: Internationalization refers to the process of increasing the enterprise of a certain local company in the international market while globalization refers to the process of integration of local markets into one global market.

- Focus: Their focus is another difference between internationalization and globalization. The focus of internationalization is the expansion of the client base of a local business in the global or international market whereas the focus in globalization is the exchange of products and services from the interaction of local markets in one global market. And, this enhances free trade and capital mobility services as well.

- Result: The results of internationalization include increasing the influence of the enterprise of a local market and influencing globalization. The results of globalization include the decrease of global market trade barriers, the emergence of free and open markets, the mobility of free trade capital, increased and uncontrollable migration, decline of local cultures and identities and the negative effect on the small local business.

Relationship Between Internationalization and Globalization

- Internationalization has a direct influence on creating globalization; the global trend for internationalization has contributed greatly to drive the global economy to globalization.
- Hence, the local economies get connected to other local economies to gain the commercial advantages of globalization.
- The main difference between internationalization and globalization is that internationalization refers to the way in which a certain company or a market increase its footprint or influence in the international market while globalization refers to the process where the local markets and economies, on the whole, connect with those in other countries sharing the universally accepted rules and regulations.

Stages of Internationalisation

- Most companies pass through different stages of internationalisation. There are, of course many companies which have international business, since their very beginning, including hundred per cent export oriented companies.
- Even in the case of many of the hundred per cent, Export Import companies, the development of the international business would pass through different stages of evolution. A firm which is entirely domestic in its activities normally passes through different stages of internationalisation before it becomes a truly Global one.
- There are many companies which enthusiastically and systematically go International as part of the corporate plan. However, in the case of many firms, the initial attitude towards international business is passive and they get into international business in response to some extra stimuli.
- A firm may start exports on an experimental basis and if the results are satisfied it would enlarge the international business and in due course it would establish offices branches of subsidiaries or joint ventures abroad.
- The expansionary process may also be characterized by increasing the product mix and the number of market segments, market and countries of operation.

Stages of Internationalisation

- In the process the company could be expected to become multinational and finally the Global.
- In short, in many firms Overseas business initially starts with a low degree of commitment or involvement; but they gradually developed a Global Outlook and embark upon overseas business in a big way.
- The important stages in the evolutionary process are following:
- **Domestic Company**: Most International companies have their great origin as domestic companies. The orientation of a domestic company essentially is ethnocentric. A purely domestic company operates domestically because it never considered the alternative of going International. The growing stage 1 company, when it reaches growth limit in its primary market diversifies into new markets product technologies instead of focusing on penetrating International markets.
- However, if factors like domestic market constraints, foreign market prospects, increasing competition etc. make the company reorient its strategies to tap foreign markets potential, it would be moving to the next stage in the evolution.

Stages of Internationalisation

- A domestic company may extend its products to foreign markets by exporting, licensing and franchising. The company, however, is primarily domestic and the orientation essentially is Ethnocentric. The company may develop a more serious attitude towards a foreign business and move to the next stage of development, i.e., international company.

- **International company**: It is normally the second stage in the development of a company towards the transitional corporation. The orientation of the company is basically ethnocentric and the marketing strategy is extension, i.e., the marketing mix "developed" for the home market is extended into foreign market. International company is normally rely on the international business.

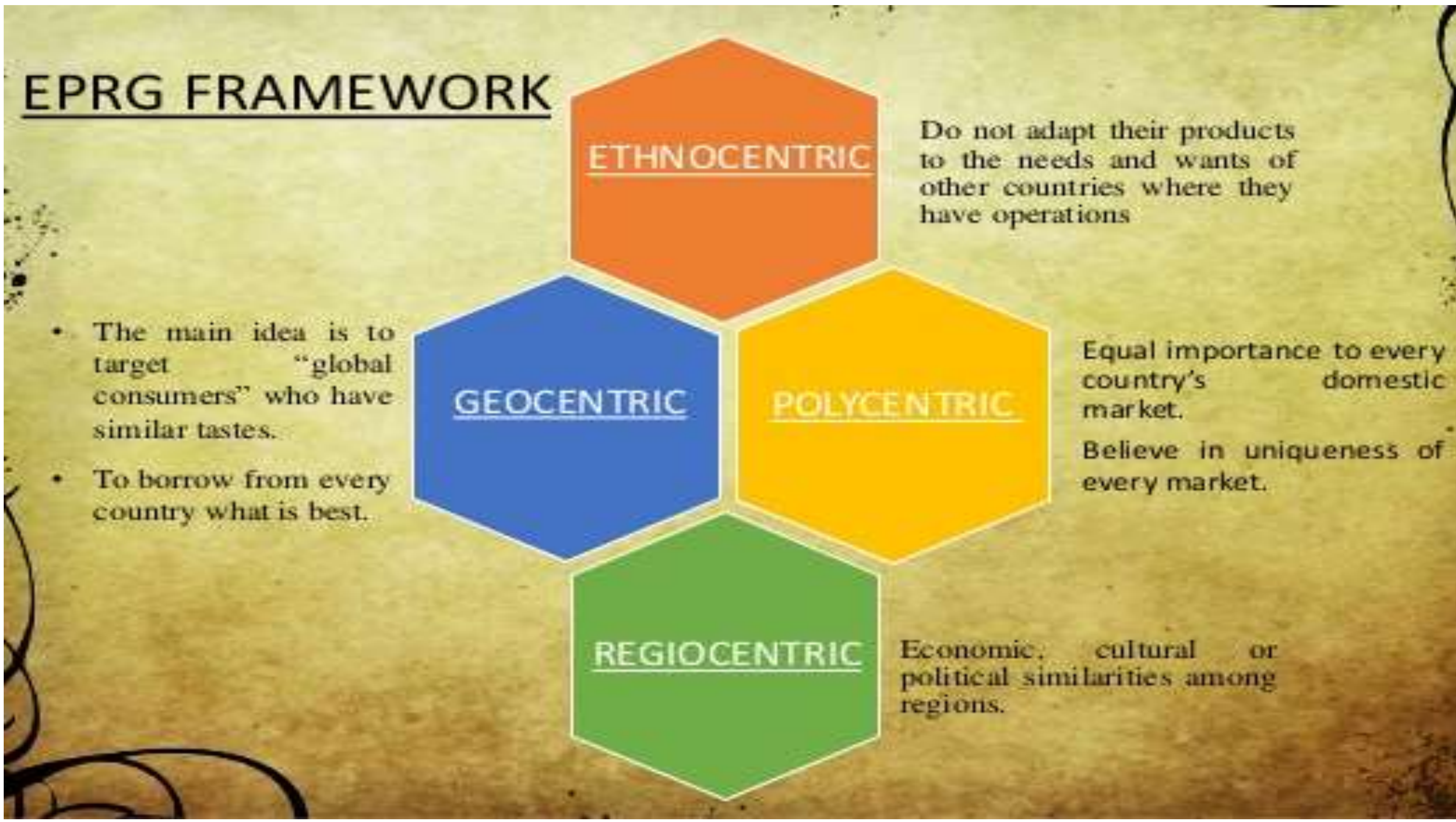
- **Multinational company:** When the orientation shifts from ethnocentric to polycentric, the international company becomes multinational. In other words, when a company decides to respond to market differences, it evolves into a stage 3 multinational that persuades a multi-domestic strategy. The focus of the stage 3 company is multidimensional that pursues a multinational or, in strategic term multi-domestic. The marketing strategy of the multi-dimensional company is adaptation.

Stages of Internationalisation

- In multinational companies is foreign subsidiary is managed as if it were an independent city state. The subsidiaries are part of an area structure in which each country is a part of a regional organisation that reports to world headquarters.
- The Global company will have either a global marketing strategy for a global sourcing strategy but not both. It will be the focus on the global market and source from the home or a single market Country to supply its domestic channel.
- However, according to the interpretation of some other all strategies, i.e., product development production and marketing etc. will be Global in respect of the Global Corporation.
- The transitional corporation is much more than a company with sales, investment, and operations in many countries. This company which is increasingly dominating Markets and industries around the world is an integrated world enterprise that links the Global resources with Global markets at a profit.

EPRG Framework

- Different attitudes towards company's involvement in international marketing process are called international marketing orientations.
- EPRG framework was introduced by Wind, Douglas and Perlmutter. This framework addresses the way strategic decisions are made and how the relationship between headquarters and its subsidiaries is shaped.
- Perlmutter's EPRG framework consists of four stages in the international operations evolution. These stages are discussed below.



EPRG Framework

- **1. ETHNOCENTRIC ORIENTATION (Home country orientation):** In this approach, A firm employs home market strategies to the international market. Plans for overseas market are developed in the home office of the company.
- Personnel is hired from home country. Also, promotion and distribution strategies are similar to that employed in the home country.
- **These people or companies believe that the home country is superior. When they look to new markets they rely on what they know and seek similarities with their own country. Overseas subsidiaries or offices in international markets are seen as less able and less important than the head office. Typically, these companies make few adaptations to their products and undertake little research in the international markets.**
- **In these companies, opportunities outside the home country are ignored. Such companies are also sometimes referred to as domestic companies. Ethnocentric companies that do business outside the home country can be described as international companies; they adhere to the notion that the products that succeed in the home country are superior and can, therefore, be sold everywhere without adaptation.**

EPRG Framework

- **2. POLYCENTRIC APPROACH (Host country orientation):** In this approach, marketing strategies are framed out as per the situation of the host country (the country where subsidiary is situated). Decisions can be altered as per the economic, political and cultural disparities in the country.
- This provides a firm to manage its operations independently, without much interference from its headquartered.
- **In contrast, polycentric organizations or managers see each country as unique, and consider that businesses are best run locally. Polycentric management means that the head office places little control on the activities in each market, and there is little attempt to make use of any good ideas or best practices from other markets.**
- **The term polycentric describes management's often-unconscious belief or assumption that each country in which a company does business is unique. This assumption lays the groundwork for each subsidiary to develop its unique business and marketing strategies in order to succeed. The term multinational company is often used to describe such a structure.**

EPRG Framework

- **3. REGIOCENTRIC ORIENTATION:** In this approach, a firm treats a group of countries with similar characteristics as a single market and accordingly designs a marketing strategy. Countries like India, Pakistan and Bangladesh possess similar characteristic and can be served well with a single marketing strategy.
- **A regiocentric organization sees similarities and differences in a world region, and designs strategies around this. Often there are major differences between countries in a region. For example, Norway and Spain are both in Europe, but are very different in climate, culture, transport, retail distribution, and so on.**
- **For example, a US company, which focuses on countries included in the North American Free Trade Agreement (NAFTA)- the United States, Canada, and Mexico, has a region-centric orientation. Similarly, if companies of ASEAN member countries focus only on South East Asia, then they are said to have regiocentric orientation.**

EPRG Framework

- **4. GEOCENTRIC APPROACH:** This approach maintains a balance between home and host market. Marketing strategies are not influenced by the home or host country preferences.
- A firm tries to adopt globalized marketing, formulates an integrated marketing strategy for across the globe. this enables a firm to enjoy economies of scale.
- **Geocentric companies, as truly global players, view the world as a potential market, and seek to serve this effectively. Geocentric management can recognize the similarities and differences between the home country and the international markets. It combines ethnocentric and polycentric views; in other words, it displays the "think global, act local" ideology.**
- **The geocentric orientation represents a synthesis of ethnocentrism and polycentricism into a 'world view' that sees similarities and differences in markets and countries, and seeks to create a global strategy that is fully responsive to local needs and wants.**