Unit 1

Types of International Business

1. **Exporting:**

   Exporting is often the first choice when manufacturers decide to expand abroad. Simply stating, exporting means selling abroad, either directly to target customers or indirectly by retaining foreign sales agents or/and distributors. Either case, going abroad through exporting has minimal impact on the firm's human resource management because only a few, if at all, of its employees are expected to be posted abroad.

2. **Licensing:**

   Licensing is another way to expand one's operations internationally. In case of international licensing, there is an agreement whereby a firm, called licensor, grants a foreign firm the right to use intangible (intellectual) property for a specific period of time, usually in return for a royalty. Licensing of intellectual property such as patents, copyrights, manufacturing processes, or trade names abound across the nations. The Indian basmati (rice) is one such example.

3. **Franchising:**

   Closely related to licensing is franchising. Franchising is an option in which a parent company grants another company/firm the right to do business in a prescribed manner. Franchising differs from licensing in the sense that it usually requires the franchisee to follow much stricter guidelines in running the business than does licensing. Further, licensing tends to be confined to manufacturers, whereas franchising is more popular with service firms such as restaurants, hotels, and rental services.

   One does not have to look very far to see how important franchising business is to companies here and abroad. At present, the prominent examples of the franchise agreements in India are Pepsi Food Ltd., Coca-Cola, Wimpy's Damino, McDonald, and Nirula. In USA, one in 12 business establishments is a franchise.

   However, exporting, licensing and franchising make companies get them only so far in international business. Companies aspiring to take full advantage of opportunities offered by foreign markets decide to make a substantial direct investment of their own funds in another country. This is popularly known as Foreign Direct Investment (FDI). Here, by international business means foreign direct investment mainly. Let us discuss some more about foreign direct investment.

4. **Foreign Direct Investment (FDI):**

Foreign direct investment refers to operations in one country that ire controlled by entities in a foreign country. In a sense, this FDI means building new facilities in other country. In India, a foreign direct investment means acquiring control by more than 74% of the operation. This limit was 50% till the financial year 2001-2002.

There are two forms of direct foreign investment: joint ventures and wholly-owned subsidiaries. A joint venture is defined as “the participation of two or more companies jointly in an enterprise in which each party contributes assets, owns the entity to some degree, and shares risk”. In contrast, a wholly-owned subsidiary is owned 100% by the foreign firm.

An international business is any firm that engages in international trade or investment. International trade refers to export or import of goods or services to customers/consumers in another country. On the other hand, international investment refers to the investment of resources in business activities outside a firm’s home country.

International Organizational Design & Structures

International Organizational Structures: Type # 1

Expo-documents against acceptancert Department:

Exports are often looked after by a company’s marketing or sales department in the initial stages when the volume of exports sales is low. However, with increase in exports turnover, an independent exports department is often setup and separated from domestic marketing, as shown in Fig. 17.2.

Exports activities are controlled by a company’s home-based office through a designated head of export department, i.e. Vice President, Director, or Manager (Exports). The role of the HR department is primarily confined to planning and recruiting staff for exports, training and development, and compensation.

Sometimes, some HR activities, such as recruiting foreign sales or agency personnel are carried out by the exports or marketing department with or without consultation with the HR department.

International Organizational Structures: Type # 2

International division structure:

As the foreign operations of a company grow, businesses often realize the overseas growth opportunities and an independent international division is created which handles all of a company's international operations (Fig. 17.3). The head of international division, who directly reports to the chief executive officer, coordinates and monitors all foreign activities.

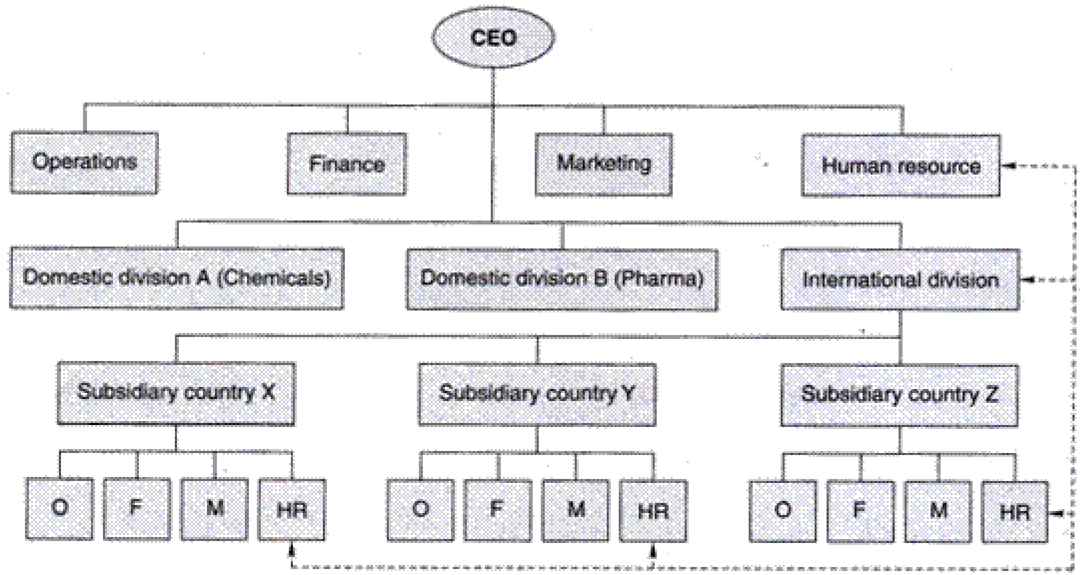


Fig. 17.3 International division structure

The in-charge of subsidiaries reports to the head of the international division. Some parallel but less formal reporting also takes place directly to various functional heads at the corporate headquarters.

The corporate human resource department coordinates and implements staffing, expatriate management, and training and development at the corporate level for international assignments. Further, it also interacts with the HR divisions of individual subsidiaries.

The international structure ensures the attention of the top management towards developing a holistic and unified approach to international operations. Such a structure facilitates cross-product and cross-geographic co-ordination, and reduces resource duplication.

Although an international structure provides much greater autonomy in decision-making, it is often used during the early stages of internationalization with relatively low ratio of foreign to domestic sales, and limited foreign product and geographic diversity.

International Organizational Structures: Type # 3

Global Organizational Structures:

Rise in a company's overseas operations necessitates integration of its activities across the world and building up a worldwide organizational structure.

While conceptualizing organizational structure, the internationalizing firm often has to resolve the following conflicting issues:

1. Extent or type of control exerted by the parent company headquarters over subsidiaries
2. Extent of autonomy in making key decisions to be provided by the parent company headquarters to subsidiaries (centralization vs. decentralization)

It leads to re-organization and amalgamation of hitherto fragmented organizational interests into a globally integrated organizational structure which may either be based on functional, geographic, or product divisions. Depending upon the firm strategy and demands of the external business environment, it may further be graduated to a global matrix or trans-national network structure.

Global functional division structure:

It aims to focus the attention of key functions of a firm, as shown in Fig. 17.4, wherein each functional department or division is responsible for its activities around the world. For instance, the operations department controls and monitors all production and operational activities; similarly, marketing, finance, and human resource divisions co-ordinate and control their respective activities across the world.

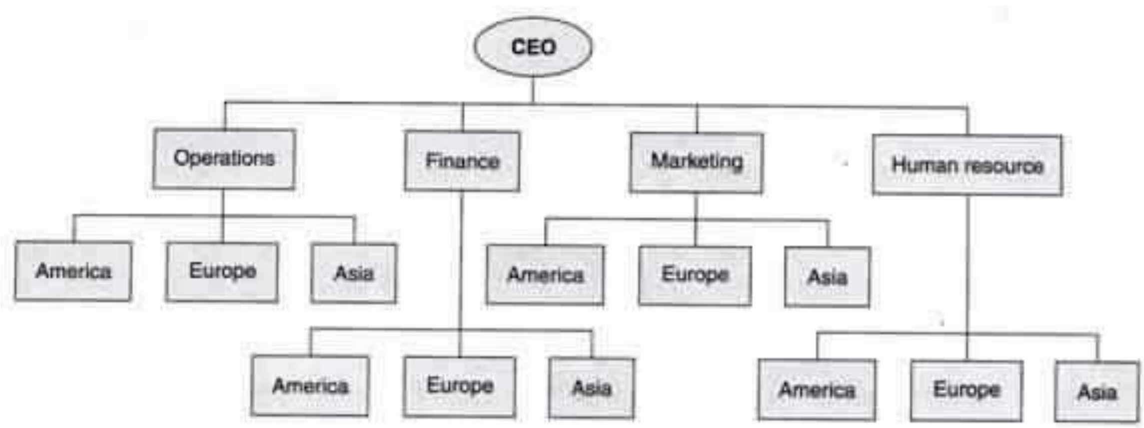


Fig. 17.4 Global functional division structure

Such an organizational structure takes advantage of the expertise of each functional division and facilitates centralized control. MNEs with narrow and integrated product lines, such as Caterpillar, usually adopt the functional organizational structure.

Such organizational structures were also adopted by automobile MNEs but have now been replaced by geographic and product structures during recent years due to their global expansion.

The major advantages of global functional division structure include:

1. Greater emphasis on functional expertise
2. Relatively lean managerial staff

iii. High level of centralized control

1. Higher international orientation of all functional managers

The disadvantages of such divisional structure include:

1. Difficulty in cross-functional coordination
2. Challenge in managing multiple product lines due to separation of operations and marketing in different departments

iii. Since only the chief executive officer is responsible for profits, such a structure is favoured only when centralized coordination and control of various activities is required.

Global product structure:

Under global product structure, the corporate product division, as depicted in Fig. 17.5, is given worldwide responsibility for the product growth.

The heads of product divisions do receive internal functional support associated with the product from all other divisions, such as operations, finance, marketing, and human resources. They also enjoy considerable autonomy with authority to take important decisions and operate as profit centres.

Fig. 17.5 Global product structure

The global product structure is effective in managing diversified product lines.

Such a structure is extremely effective in carrying out product modifications so as to meet rapidly changing customer needs in diverse markets. It enables close coordination between the technological and marketing aspects of various markets in view of the differences in product life cycles in these markets, for instance, in case of consumer electronics, such as TV, music players, etc.

However, creating exclusive product divisions tends to replicate various functional activities and multiplicity of staff. Besides, little attention is paid to worldwide market demand and strategy. Lack of cooperation among various product lines may also result into sales loss. Product managers often pursue currently attractive markets neglecting those with better long-term potential.

Global geographic structure:

Under the global geographic structure, a firm's global operations are organized on the basis of geographic regions, as depicted in Fig. 17.6. It is generally used by companies with mature businesses and narrow product lines. It allows the independent heads of various geographical subsidiaries to focus on the local market requirements, monitor environmental changes, and respond quickly and effectively.

Fig. 17.6 Global geographic structure

The corporate headquarter is responsible for transferring excess resources from one country to another, as and when required. The corporate human resource division also coordinates and provides synergy to achieve company's overall strategic goals between various subsidiaries based in different countries.

Such structure is effective when the product lines are not too diverse and resources can be shared. Under such organizational structure, subsidiaries in each country are deeply embedded with nationalistic biases that prohibit them from cooperating among each other.

Global matrix structure:

It is an integrated organizational structure, which super-imposes on each other more than one dimension. The global matrix structure might consist of product divisions intersecting with various geographical areas or functional divisions (Fig. 17.7). Unlike functional, geographical, or product division structures, the matrix structure shares joint control over firm's various functional activities.

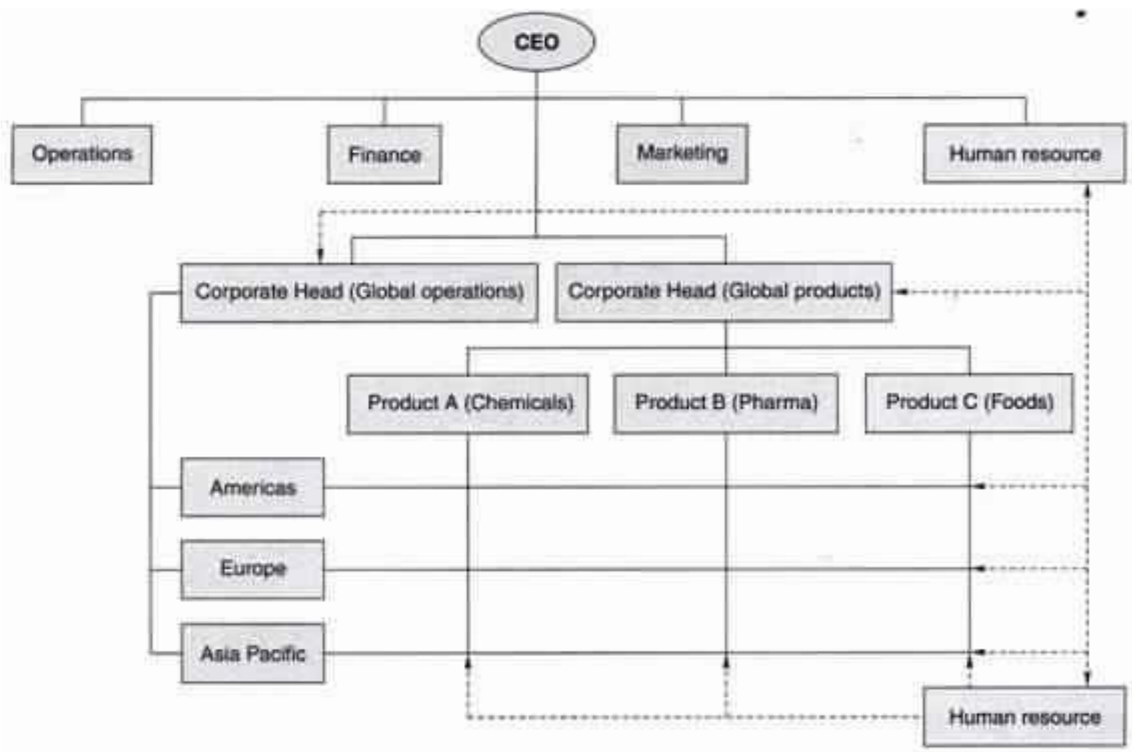


Fig. 17.7 Global matrix structure

Such an integrated organizational structure facilitates greater interaction and flow of information throughout the organization. Since the matrix structure has an in-built concept of interaction between intersecting perspectives, it tends to balance the MNE's prospective, taking cross-functional aspects into consideration.

It facilitates ease of technology transfer to foreign operations and of new products to different markets leading to higher economies of scale and better foreign sales performance. Matrix structure is used successfully by a large number of MNEs, such as Royal Dutch/Shell, Dow Chemical, etc.

In an effort to bring together divergent perspectives within the organization, the matrix structure may also lead to conflicting situations. It inhibits a firm's ability to respond quickly to environmental changes in case an effective conflict resolution mechanism is not in place.

Since the structure requires most managers to report to two or multiple bosses, Fayol's basic principle of unity of command is violated and conflicting directives from multiple authorities may compel employees to compromise with sub-optimal alternatives so as to avoid conflict which may not be the most appropriate strategy for an organization as a whole.

Transnational network structure:

Such a globally integrated structure represents the ultimate form of an earth-spanning organization, which eliminates the meaning of two or three matrix dimensions. It encompasses elements of function, product, and geographic designs while relying upon a network arrangement to link worldwide subsidiaries (Fig. 17.8).

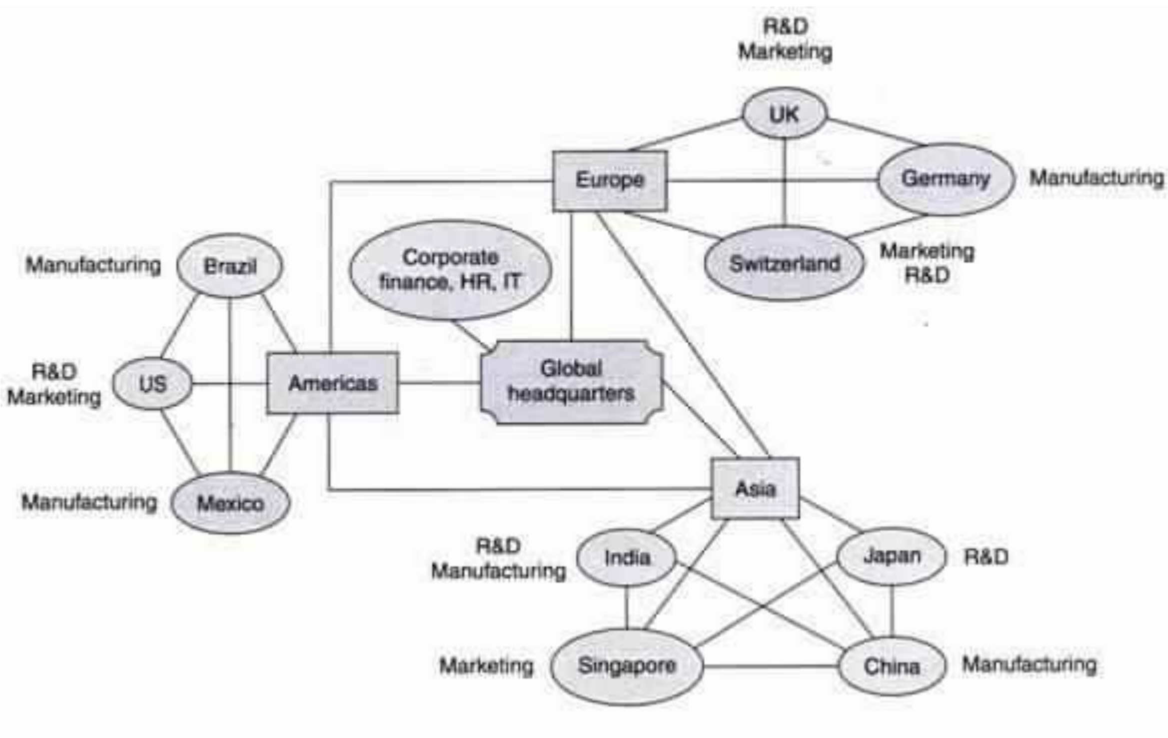


Fig. 17.8 Transnational network structure

This form of organization is not defined by its formal structure but by how its processes are linked with each other, which may be characterized by an overall integrated system of various inter-related sub-systems.

The trans-national network structure is designed around 'nodes', which are the units responsible for coordinating with product, functional and geographic aspects of an MNE.

Thus, trans-national network structures build-up multidimensional organizations which are fully networked.

The conceptual framework of a trans-national network structure primarily consists of three components:

Disperse sub-units:

These are subsidiaries located anywhere in the world where they can benefit the organization either to take advantage of low-factor costs or provide information on new technologies or market trends

Specialized operations:

These are the activities carried out by sub-units focusing upon particular product lines, research areas, and marketing areas design to tap specialized expertise or other resources in the company's worldwide subsidiaries.

Inter-dependent relationships:

It is used to share information and resources throughout the dispersed and specialized subsidiaries.

Organizational structure of N.V. Philips which operates in more than 50 countries with diverse range of product lines provides a good illustration of a trans-national network structure.

International Organizational Structures: Type # 4

Evolution of Global Organizational Structures:

Organizational structures often exhibit evolutionary patterns, as shown in Fig. 17.9, depending upon their strategic globalization. The historical evolution of organizational patterns indicates that in the early phase of internationalization, most firms separate their exports departments from domestic marketing or have separate international divisions.

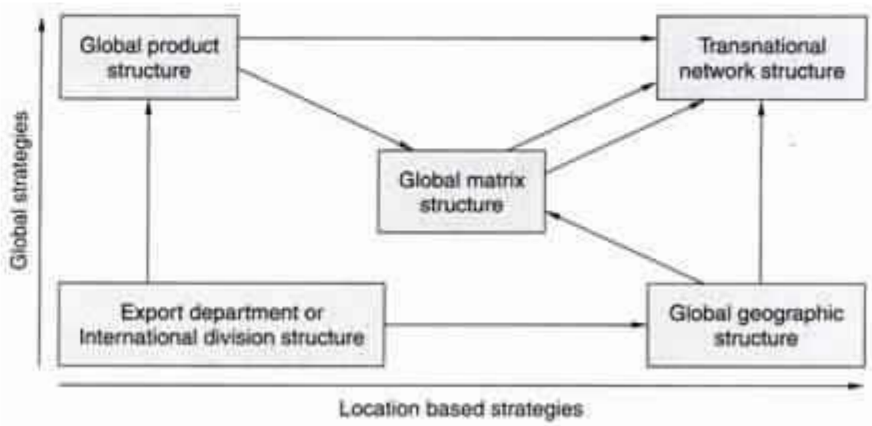


Fig. 17.9 Evolution of global organizational structures

Companies with emphasis on global business strategies move towards global product structures whereas those with emphasis on location base strategies move towards global geographic structures.

Risk in International Business

Risk happens on account of uncertainty about happening of an event like loss, damage, variations in foreign exchange rates, interest rate variations, etc. Every business manager is always risk averters, i.e., managers usually do not want to take risk. Hence, he likes to work out higher probability for creating wealth and profit. He likes to work as hedger.

The risk taker would like to take risk. He normally works as speculator. Any change in the business environment, would bring the same type of risk. Generally, the areas of business prone to risks are shortage of inventory, shortage of business orders, shortage of manpower, shortage of utilities like power and fuel, changes in government policies, etc.

The international business faces the risk due to the following reasons:

1. Operations across and with different political, legal, taxation and culture systems.
2. Operations across and with a wider range of product and factor markets, each with different levels of competition and efficiency.
3. Trades in wider range of currencies and frequent resort to foreign exchange markets.
4. Unregulated international capital markets.

In other words, risk is the main measurement of the probability of incurring a loss or damage. The chance and possibility that the actual outcome from an activity will differ from the expected outcome normally gives rise to risk. This means that, higher the variability the possible outcomes that can occur (i.e. broader the range of possible outcomes), results in to greater risk.

Types of Risks:

The value of firm's assets, liabilities, operating incomes, operating expenses, and other abnormal incomes, expenses differ from expected one clue to changes in many economic and financial variables like exchange rates, interest rates, inflation rates etc.

The appreciation of a local currency results in decreasing the local currency value with respect to exports receivable denominated in foreign currency. Such appreciation or depreciation of local currency makes effect on the cash flow of domestic currency due to the transactions' exposure of merchandise and non-merchandise exports and imports.

Exposure is a measure of the sensitivity of the value of a financial item (cash flow, assets, liability etc.) to changes in variables like exchange rates, etc., while risk is a measure of the variability of the value of the financial item.

A firm always encounters a number of risks during the course of business, i.e. political instability, technical obsolescence, availability of skilled labour, extent of trade unionism, infrastructural bottlenecks and financial risks.

Generally risks which a firm has been categorized as:

1. Foreign exchange rate risk
2. Interest rate risk
3. Credit risk
4. Legal risk
5. Liquidity risk
6. Settlement risk
7. Political risk

Let us now discuss about all these risks in detail.

1. Foreign Exchange Rate Risk:

The variance or changes of the real domestic currency value of assets, liabilities or operating income on account of unanticipated changes in exchange rates referred as Foreign Exchange Risk. This risk relates to the uncertainty attached to the exchange rates between the two currencies.

If an Indian businessman borrows some amount viz. dollars and has to repay the loan in dollars only over a period of time, then he is said to be exposed to the foreign exchange rate risk during the currency of loan.

Thus, if the dollar becomes stronger (costly) vis-a-vis rupees (cheap) or depreciated during the period then the businessman has to repay the loan in terms of more rupees than the rupees he obtained by way of loan. The extra rupees which he pays are not due to an increase of interest rates, but because of the unfavourable foreign exchange rate.

On the contrary, he gains if the dollar weakens vis-a-vis rupee because of favourable exchange rate. Anyway, the businessman would like to protect his business from unfavourable exchange rate by adopting a number of hedging techniques and would like to optimise his gains in case of favourable exchange rate situation. This mechanism, in short, is known as Foreign Exchange Risk Management.

Indian business was not very much exposed to this risk as the exchange rate in India operated in RBI controlled regime. However, with the advent of the budget for 1993-94, a new era was ushered in by opening up Indian economy to the International market.

The various steps taken for encouraging globalization have made the Indian business vulnerable to foreign exchange rate risk. Hence, exchange rate risk exposure is considered to be an important factor while conducting business in India.

The types of foreign exchange risks and exposure are:

1. Transaction exposure
2. Translation exposure
3. Economic exposure, and
4. Operating exposure

2. Interest Rate Risk:

The fluctuations in interest rates over a period of time change the cash flow need of a firm, for interest payment. The rate of interest is decided and agreed among parties (i.e. lender and borrower) at the time of sanctioning of debt.

The interest rate may be constant or may be related to some other variable or benchmark. If it is constant, it is known as, 'Fixed Interest Rate Debt Instrument' (FXR). If the rate is linked to any other variable or benchmark say LIBOR (London Inter-Bank Offer Rate) then known as Floating Interest Rate Debt Instrument (FIR).

Interest Rate Exposure and Risk:

Interest rate uncertainty exposes a firm to the following types of risks. Borrowings on floating rate bring uncertainty relating to future interest payments, for the firm. The floating rate makes borrowing cost of capital unknown.

The problem is that there is a rise of variation in interest rate risk for the firm due to the fluctuating or floating rate clause in loan agreement. Hence, firm management not sure about the interest payment they have to make whenever interest amount is payable to financial institutions or lenders of the funds. Borrowings on fixed rate basis results in risk if future periods interest rates may come down, and the firm has to continue with a heavy burden on debt servicing.

In the Indian environment, the management of interest rate risks has been a comparatively new concern. The behaviour of interest rates during the period of 2003-2008 has upset the cost and return calculations of many industries.

The exchange rate fluctuation in the South East Asian Countries or the nosedive (sudden plunge or changes) of rupee in terms of dollars shows the extreme sensitivity of exchange rates, and in turn the extent to which the firm's exposures affected.

Interest rates in India were regulated and controlled by the dictates of the Reserve Bank of India. This ensured a stability of interest rate mechanism and the Indian business was not very much bothered about them. However, with changes being brought out by the Government and Reserve Bank of India, it is quite clear that interest rates will henceforth be market driven.

3. **Credit Risk:**

A credit risk is the risk, in a transaction, of counter party of the transaction failing to meet its obligation towards the transaction. This risk is present in all trade and commerce transactions, thus it also includes the transactions relating to foreign trade and foreign exchange.

4. **Legal Risk:**

The risk arising due to legal enforceability of a contract or a transaction is known as legal risk. The contract is normally unenforceable due to pending, or newly created, political and legal issues between the two trading countries. The various legal taxes, controls, regulations, exchange and trade controls, controls on financial transactions, controls on tariff, and quotas system, are risks factors or elements in foreign trade and finance flows.

5. **Liquidity Risk:**

If the markets turn illiquid or the positions in market are such that cannot be liquidated, except huge price concession, the resultant risk is known as liquidity risk. It can also be termed that the risks which, though directly or indirectly, affect the liquidity and in turn long term solvency of the parties in the market, is known as liquidity risk.

The international financial system failed to support the increasing demands of expanding trade and finance due to lack of enough resources, efficient and quick actions of surveillance on capital flows and inadequate liquidity to meet emerging crisis situations.

6. **Settlement Risk:**

This is the risk of counterparty failing during settlement, because of time difference in the markets in which cash flows the two currencies have to be paid and received viz. settled.

Settlement risk depends on the various risks like risk of the borrowing company's ability to meet its debt service obligation in time, represented by the risk of its business, financial risk, market risk, labour problems, restrictions on dividend distribution, fluctuations in profits and a host of other company related problems. Unanticipated depreciation of a country's currency might hurt a company which is net importer but it may benefit exporter.

7. Political Risk:

Political Risk is the risk that results from political changes or instability in a country. Such variability or changes always result into some kind of changes in the monetary, fiscal, legal, and other policies of the country facing the changes.

It has adverse impact on the working of the financial and commercial operation carried out by the country with the globe, and also of foreign enterprise located in host country. When a factor of instability is found with a country, such kind of risk crop up, and affect the foreign trade and exchange of the country adversely. The political risk results in to uncertainty over property rights and protection of wealth.

Types of Political Risk:

Political Risk makes the impact on direct and indirect investments in the host country as well as the inter-trading transactions. The government measure also tends to limit the working and operations of foreign firm in the country.

Political Risk can broadly classify into the following four categories:

1. Country Risks
2. Sector Risks
3. Project Risks
4. Currency Risks

1. Country Risks:

Country risks emanate from political, social and economic instability of a country, and bring hostility towards foreign investments. The hostility develops during the periods of crisis and forces the few governments to nationalize core industrial sectors based on strategic importance of the same.

The political risk takes several forms, such as nationalization or expropriation without indemnity (Compensation). The major episodes in this context are nationalization in Iran (1978), Libya (1969), Algeria (1962); nationalization with indemnity, such as in Chile (1971). Above all latent Nationalisation in terms of compulsory local or governmental participation constitutes another variant of political risk.

The concerns may veer (opinion or moving around some perception related questions) round the following questions:

1. How stable is that government?
2. Are government policies reasonably consistent over time?
3. Is political power concentrated or diffused? Is it administered by a strong central government or by a more federal allocation of power?
4. How insulated is the government from changes in public opinion, particularly with respect to foreign investment and trade issues?
5. Is the government relatively strong or weak?
6. What is the country's record of compliance with international agreements, including sovereign debt obligations?
7. How strong is the rule of law? Are laws and contracts generally enforced by an accessible, fair, and impartial judiciary?
8. Are there social and economic factors of special concern (for example, environmental protection, human rights, labour standards, or inequitable allocation of wealth or income)?

2. Sector Risks:

Generally, sectors like Petroleum, Mining, and Banking and so on are the sectors which are prone to greater element of political risk in a country in comparison to other sectors, because such sectors directly affect the climate for foreign investment.

For instances, petroleum sector has been nationalized in various countries such as Mexico (1938), Libya (1968), Iraq (1972), Venezuela and Kuwait (1975), Iran (1978) and Nigeria (1979). Likewise, nationalization of copper mines took place in Zaire, Zambia, and Chile and of Iron mines in Venezuela. Banking sector was nationalized in Guinea (1962), Vietnam (1975) and Iran and Nicaragua (1978).

3. ***Project Risks:***

Generally, not only country and sector but also the specific project is subject to risk. Multinationals establishes big projects in foreign countries, like electricity generation plants, dams, exploration of petroleum fields, etc. such project requires a huge investment in the beginning and as gestation period is long enough the risk enhances.

In the event of the project turning to be successful (for example finding an exploitable petroleum field), some governments are very demanding, and in certain situations, in particular, with the change of government the latter may even refuse to respect the engagement of the predecessor. In the year 1995, a new Government of the Maharashtra State in India refused to fulfill the agreement of the previous government for a large electricity project, named Enron project.

The need happens to focus on analytical framework before taking up an activity, to ensure that effective risk management can be achieved in practical context. The risk management activity to be undertaken with respect to particular industry, sector and/or project and also the nature of parties involved in it, hence, the integration of all parameters is needed.

The assessment and determination of risk is a highly subjective and theoretical. In such circumstances, the decisions taken by the managers are more often influenced by management's view of the future of the sector, and their desire to achieve the excellence performance, in addition to their knowledge based on past experience.

4. ***Currency Risks:***

A currency risk arises due to imbalance in the balance-of-payments of a country. In last decade, changes in the macro-economic situation and resulting national controls on capital flows and foreign investment and borrowings resulted into Asian crisis. It is needed to monitor various macro-economic situations and national control as they result into currency risk and it affects the private sector infrastructure projects.

In short, risk can be evidenced when the exact relationship between the causes of risk and its impact on the economy cannot be established. For this purpose by application of the statistical techniques, probabilities can be worked out for each possible event. It is always solely subjective assessment.

Risk Analysis:

Risk analysis, being a component of risk management process, deals with the various kinds of events and causes and effects of these events which may resultantly cause harm to the functioning of the firm. Risk analysis supports the business managers to work out the proper decisions in business working.

Risk analysis is done on the basis of the possibility of an event taking place. Thus, the risk of an event can be measured through the possibility (probability) of the event taking place with regards to the frequency and severity.

An event can have wide variety of characteristics or possibility with respect to varying degrees of seriousness, depending upon its nature and the extent of damage it can create, and the perception of the event's occurrence taken by the management. Each project or activity can have many associated risks, and these risks can vary depending upon technology, funding, organisations involved etc.

However, in broad terms, the key sources of project or process risks are like:

1. Commercial risk
2. Financial risk
3. Legal risks
4. Political risks
5. Social risks
6. Environmental risks
7. Communications risks
8. Geographical risks

9. Geotechnical risks
10. Construction risks
11. Technological risks
12. Operational risks
13. Demand or product risks, and
14. Management risks etc.

These sources of risk directly influence the project-specific and non-project-specific performance. The analyst is supposed to define the boundaries of each risk driver and its detailed risk elements. Then, he/she has to move to estimate the impact of the same.

The decision with respect to division of risks into specific element; and later on evaluates. The parameters of evaluations are generally affected by personal subjectivity and belief of the financial analyst. The risk analysis explores the avenues for business managers to take informed decision.

Motives for International Business

1. INCREASE SALES AND PROFITS

If your business is succeeding in your domestic market, expanding globally will likely improve overall revenue. Economic growth rates in Europe, USA and Japan are very low compared to the large and new emerging markets. In Europe live around 300 million people as well as in the USA. Only in China and India, we can approach more than 2.4 billion potential consumers. This suggests customers are global and that if your company looks beyond the shores of the domestic market, you have some real upside potential. If your company has a unique product or technological advantage not available to international competitors then this advantage should result in major business success abroad. Sales in foreign markets can also be at a higher price (an margin) than in the domestic market. Many imported products are paid as premium products and brands. Therefore, more sales in foreign markets, generally brings more profits.

2. SHORT AND LONG TERM SECURITY

Your business will be less vulnerable to periodic fluctuations and downturns in the Spanish or European economy and marketplace. Generally speaking, the Eurozone is a large, mature market with intense competition from domestic and foreign competitors. During these years of deep economic recession, exports were the solution for many Spanish companies. Thanks to these sales to foreign markets many companies could keep and also improve their production capacity, employment and financial structure.

3. INCREASE INNOVATION AND MANAGEMENT LEARNING

Extending your customer base internationally can help you finance new product development, learning from competitive markets and competitors, and get use to work with very demanding and sophisticated customers. A company can benefit so much from participating in a tough and competitive market and that its own product design and marketing would improve and enable it to perform better around the world.

In most sectors, participation in the “**lead marke**t” would be a prerequisite for qualifying as a global leader or global brand, even if profits in that market were low. Lead markets include: United States for software and IT, Japan for consumer electronics, Italy and France for fashion, Germany for automobiles and so on.

It should be noted that if a company is to maximize learning from a lead market, it should probably participate with its own subsidiary.

Learning indirectly, via a local distributor or partner, is obviously less effective and will contribute less to the company’s development as a global player.

4. ECONOMIES OF SCALE

Exporting is an excellent way to expand your business with products that are more widely accepted around the world. In many manufacturing industries, for example, internationalization can help companies achieve greater scales of economy, especially for companies from smaller domestic markets. In other cases, a company may seek to exploit a unique and differentiating advantage (intellectual property), such as a brand, service model, or patented product. The emphasis should be on “more of the same,” with relatively little adjustment to local markets, which would undermine scale economies

5. COMPETITIVE STRIKE

Market entry can prompt not by the positive characteristics of the country identified in a market assessment project, but as a reaction to a competitors’ moves. A common scenario is market entry as a follower move, where a company enters the market because a major competitor has done so. This is obviously driven by the belief that the competitor would gain a significant advantage if it were allowed to operate alone in that market. Another frequent scenario is “offense as defense”, in which a company enters the home market of a competitor usually in retaliation for an earlier entry into its own domestic market. In this case, the objective is also to force the competitor to allocate increased resources to an intensified level of competition.

SUMMARY

Above are some of the good reasons to go global, among other many that a company can have: following local customers, extended product life cycle, searching for raw materials or other inputs, delocalization in order to reduce production costs, saturation of the local market, etc.

A strategic decision once the company decides to internationalize will be the approach to entering the international market. Different circumstances will be prevalent in different markets and for different companies. In all cases it is strongly advised to undertake serious thought and much preparation. Research foreign property and understand the customer culture of your overseas operations. This analysis and research will provide the company with the adequate information to make sound entry decisions and to implement a sound marketing mix strategy in the new international scenario.

Barriers to International Business

Firms desiring to enter international business face several obstacles; some are much more severe than others. The most common barriers to effective business are cultural, social, and political barriers, and tariffs and trade restrictions.

The first one to effective business is the cultural and social barriers. A nation's culture and social forces can restrict international business activities. Culture consists of a country's general concepts and values and tangible items such as food, clothing, and building. Social forces include family, education, religion and customs. Selling products from one country to another is sometimes difficult when the cultures of the two countries differ significantly. For example, when McDonald's opened its first restaurant in Rome, it was met with protest. The people of Rome objected to the smell of hamburgers frying. McDonald's overcame this objection by changing the exhaust system of the restaurant.

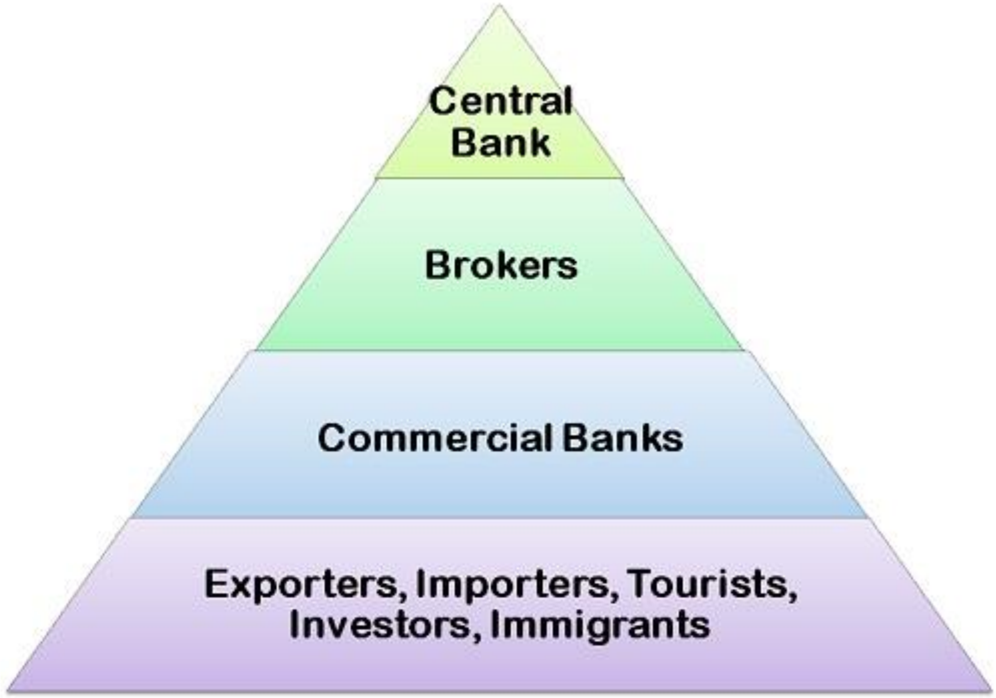
The **second barrier** is the social forces that can create obstacles to international trade. In some countries, purchasing items as basic as food and clothing can be influenced by religion. In many nations, individuals do not have the same choices in food, clothing, and health care.

The **third one** is political barriers. The political climate of a country can have a major impact on international business. Nations experiencing intense political unrest may change their attitude toward foreign firms at any time; this instability creates an unfavorable atmosphere for international trade.

The last one is the tariffs and trade restrictions. Tariffs and trade restrictions are also barriers to international business. A nation can restrict trade through import tariffs, quotas and embargoes, and exchanges controls.

Foreign Exchange Market: Nature, Structure, Types of Transactions

The **Foreign Exchange Market** is a market where the buyers and sellers are involved in the sale and purchase of foreign currencies. In other words, a market where the currencies of different countries are bought and sold is called a foreign exchange market.



The structure of the foreign exchange market constitutes central banks, commercial banks, brokers, exporters and importers, immigrants, investors, tourists. These are the main players of the foreign market, their position and place are shown in the figure below.

At the bottom of a pyramid are the actual buyers and sellers of the foreign currencies- exporters, importers, tourist, investors, and immigrants. They are actual users of the currencies and approach **commercial banks** to buy it.

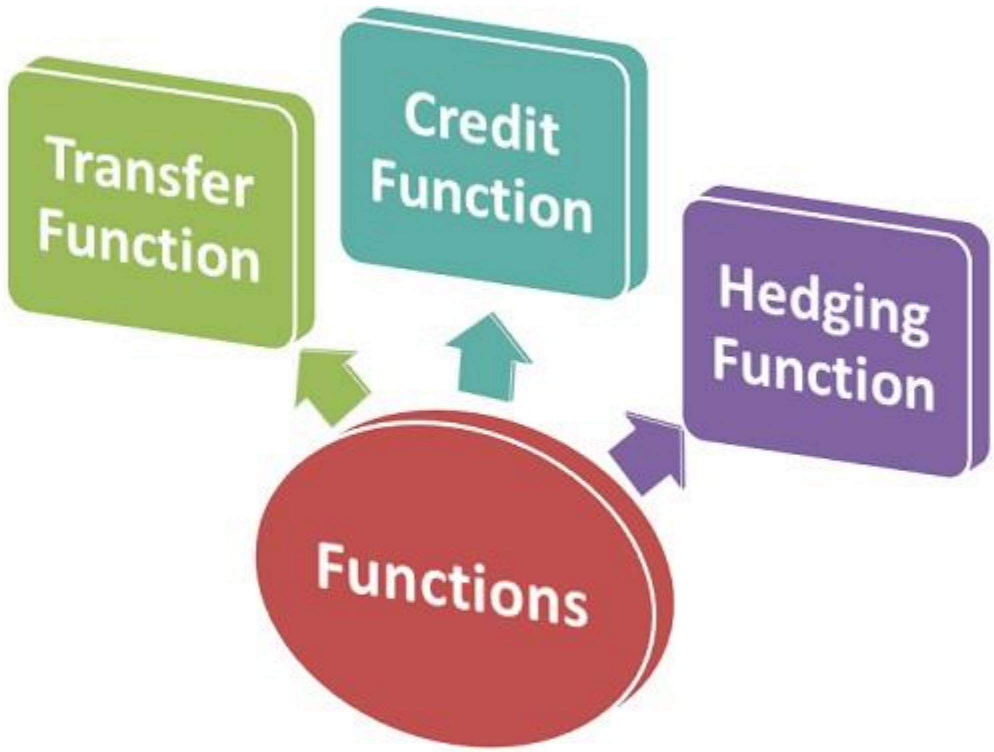
The ***commercial banks*** are the second most important organ of the foreign exchange market. The banks dealing in foreign exchange play a role of **"market makers",** in the sense that they quote on a daily basis the foreign exchange rates for buying and selling of the foreign currencies. Also, they function as **clearing houses**, thereby helping in wiping out the difference between the demand for and the supply of currencies. These banks buy the currencies from the **brokers** and sell it to the buyers.

The third layer of a pyramid constitutes the ***foreign exchange brokers***. These brokers function as a link between the central bank and the commercial banks and also between the actual buyers and commercial banks. They are the major source of market information. These are the persons who do not themselves buy the foreign currency, but rather strike a deal between the buyer and the seller on a commission basis.

The ***central bank*** of any country is the apex body in the organization of the exchange market. They work as the **lender of the last resort** and the **custodian of foreign exchange of the country**. The central bank has the power to regulate and control the foreign exchange market so as to assure that it works in the orderly fashion. One of the major functions of the central bank is to prevent the aggressive fluctuations in the foreign exchange market, if necessary, by direct intervention. Intervention in the form of selling the currency when it is overvalued and buying it when it tends to be undervalued.

Functions of Foreign Exchange Market

Foreign Exchange Market is the market where the buyers and sellers are involved in the buying and selling of foreign currencies. Simply, the market in which the currencies of different countries are bought and sold is called as a foreign exchange market.



The foreign exchange market is commonly known as FOREX, a worldwide network, that enables the exchanges around the globe. The following are the main **functions of foreign exchange market**, which are actually the outcome of its working:

1. **Transfer Function:** The basic and the most visible function of foreign exchange market is the transfer of funds (foreign currency) from one country to another for the settlement of payments. It basically includes the **conversion of one currency to another,** wherein the role of FOREX is to transfer the purchasing power from one country to another.

For example, If the exporter of India import goods from the USA and the payment is to be made in dollars, then the conversion of the rupee to the dollar will be facilitated by FOREX. The transfer function is performed through a use of credit instruments, such as bank drafts, bills of foreign exchange, and telephone transfers.

2. **Credit Function:** FOREX provides a **short-term credit** to the importers so as to facilitate the smooth flow of goods and services from country to country. An importer can use credit to finance the foreign purchases. Such as an Indian company wants to purchase the machinery from the USA, can pay for the purchase by issuing a bill of exchange in the foreign exchange market, essentially with a three-month maturity.
3. **Hedging Function:** The third function of a foreign exchange market is to **hedge foreign exchange risks**. The parties to the foreign exchange are often afraid of the fluctuations in the exchange rates, i.e., the price of one currency in terms of another. The change in the exchange rate may result in a gain or loss to the party concerned.

   Thus, due to this reason the FOREX provides the services for hedging the anticipated or actual claims/liabilities in exchange for the **forward contracts**. A forward contract is usually a three month contract to buy or sell the foreign exchange for another currency at a fixed date in the future at a price agreed upon today. Thus, no money is exchanged at the time of the contract.

There are several dealers in the foreign exchange markets, the most important amongst them are the banks. The banks have their branches in different countries through which the foreign exchange is facilitated, such service of a bank are called as **Exchange Banks**.

Types of Foreign Exchange Transactions

The **Foreign Exchange Transactions** refers to the sale and purchase of foreign currencies. Simply, the foreign exchange transaction is an agreement of exchange of currencies of one country for another at an agreed exchange rate on a definite date.

1. **Spot Transaction:** The spot transaction is when the buyer and seller of different currencies settle their payments within the two days of the deal. It is the fastest way to exchange the currencies. Here, the currencies are exchanged over a **two-day period**, which means **no contract**is signed between the countries. The exchange rate at which the currencies are exchanged is called the **Spot Exchange Rate.** This rate is often the prevailing exchange rate. The market in which the spot sale and purchase of currencies is facilitated is called as a **Spot Market**.
2. **Forward Transaction:** A forward transaction is a future transaction where the buyer and seller enter into an agreement of sale and purchase of currency **after 90 days of the deal**at a fixed exchange rate on a definite date in the future. The rate at which the currency is exchanged is called a **Forward Exchange Rate**. The market in which the deals for the sale and purchase of currency at some future date is made is called a **Forward Market**.
3. **Future Transaction:** The future transactions are also the **forward transactions**and deals with the contracts in the same manner as that of normal forward transactions. But however, the transactions made in a future contract differs from the transaction made in the forward contract on the following grounds:

- The forward contracts can be **customized**on the client's request, while the future contracts are **standardized** such as the features, date, and the size of the contracts is standardized.
- The future contracts can only be **traded on the organized exchanges,**while the forward contracts can be traded anywhere depending on the **client's convenience**.
- **No margin**is required in case of the forward contracts, while the **margins are required** of all the participants and an initial margin is kept as **collateral** so as to establish the future position.

4. **Swap Transactions:** The Swap Transactions involve a **simultaneous borrowing and lending** of two different currencies between two investors. Here one investor borrows the currency and lends another currency to the second investor. The obligation to repay the currencies is used as collateral, and the amount is repaid at a **forward rate.** The swap contracts allow the investors to utilize the funds in the currency held by him/her to pay off the obligations denominated in a different currency without suffering a foreign exchange risk.
5. **Option Transactions:** The foreign exchange option gives an investor the**right, but not the obligation** to exchange the currency in one denomination to another at an agreed exchange rate on a pre-defined date. An option to buy the currency is called as a **Call Option**, while the option to sell the currency is called as a **Put Option.**

Thus, the Foreign exchange transaction involves the conversion of a currency of one country into the currency of another country for the settlement of payments.

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Unit 2

Foreign Market entry strategies, LPG model

There are many ways in which a Company can find a route to an overseas market. There is no single market entry that works for all International markets. For many businesses direct exporting may be the best strategy while in another it may be suitable to set up a joint venture and in another it may be effective to license the manufacturing. Many factors will determine the choice of strategy, including, but not limited to, tariff rates, the degree to which you need to adapt your product, marketing and transportation costs. These factors may well increase cost to market but it would be expected that the increase in sales will offset these costs.

The following Market entry strategies can be regarded as the main options for companies:

Direct Exporting

The most common form of exporting, it's selling directly into the chosen market using your own resources initially. Many companies once they have established a sales programme turn to agents and/or distributors to represent them in that market. Distributors and Agents work closely with the company in representing the company's interests and it's critical that much time is spent in deciding the choice of agent / distributor. A good distributor / agent could transform chances of success in a chosen market and vice versa.

Acquisition of an Overseas Company

For some companies operating who want to enter a market the purchase of an existing business may be the most appropriate strategy. This may be because the company has large market share, may be a direct competitor or due to government regulation this is the only option for the company to enter the market. It will be certainly costly to acquire a business and determining the value of a company in a foreign market will require competent financial due diligence. The up-side is this market entry strategy will instantly provide the company with the standing of being a local company and will receive all the benefits of local knowledge, an established customer base and be treated by the local government as a local business.

Licensing

Licensing is quite a sophisticated arrangement where a firm transfers the rights to the use of a product or service to another company. It's a particularly beneficial if the purchaser of the license has a large share in the market that the company wants to enter. Licensing can be both for marketing or production.

Franchising

Very common in North America it's a process for rapid market expansion but it can be seen to be expanding globally. Franchising works particularly well for companies that have a good brand that has repeatable business. For example, food outlets which can be easily relocated into other markets. Two points of importance are required when considering using the franchise strategy. First, is that your business model should be unique or have a strong brand that can be leveraged internationally. The second is that you may run the risk of creating your future competition in your franchisee.

Joint Ventures

Joint Ventures are a particular form of partnership that involves creating a third independently managed company. Two companies agree to work together in a particular market, either geographic or product and create a third company to action this. Risks and profits are normally shared equally. Some good examples of a successful joint ventures are Sony/Ericsson the mobile phone company, Jaguar Land Rover sealed a joint venture with Chinese company Chery Automobile marking £1.1bn of investment into China.

Partnering

Partnering can be almost a necessity when companies enter certain foreign markets, for example Asia. Partnering can be a simple co-marketing arrangement or a sophisticated strategic alliance for manufacturing. Partnering can work well in those markets where the culture, both business and social is vastly different that the company's home market. The local partners will bring local market knowledge, contacts and even potential customers.

Turnkey Projects

Turnkey projects are normally associated to companies that provide services such as environmental consulting, architecture, construction and engineering. A turnkey project is where the facility is built from scratch and turned over to the customer and ready to go – turn the key and the factory is operational. This can be a good way to enter foreign markets as the customer is normally a government and often the project is being financed by an international financial agency such as the World Bank so the risk of not being paid is dramatically reduced.

Piggybacking

Piggybacking is a fairly unique method of entering the international marketplace. If a company has a particularly interesting and unique product or service that they sell to large domestic companies who operate on foreign markets, it may be worth approaching them to see if a product or service can be included in their sales portfolio for international markets. This reduces the risk and costs because you are essentially selling domestically and the larger company is marketing your product or service for the company internationally.

Greenfield Investments

Greenfield investments require the greatest involvement in international business. A greenfield investment is where a company purchases the land, builds the facility and operates the business on an ongoing basis in a foreign market. It's certainly the most costly option and holds the greatest risk but some markets may require companies to undertake the cost and risk due to government regulations, transportation costs and the ability to access technology or skilled labour.

Liberalization, Privatization, Globalization (LPG Model)

Liberalization

The basic aim of liberalization was to put an end to those restrictions which became hindrances in the development and growth of the nation. The loosening of government control in a country and when private sector companies' start working without or with fewer restrictions and government allow private players to expand for the growth of the country depicts liberalization in a country.

Objectives of Liberalization Policy

- To increase competition amongst domestic industries.
- To encourage foreign trade with other countries with regulated imports and exports.
- Enhancement of foreign capital and technology.
- To expand global market frontiers of the country.
- To diminish the debt burden of the country.

Privatization

This is the second of the three policies of LPG. It is the increment of the dominating role of private sector companies and the reduced role of public sector companies. In other words, it is the reduction of ownership of the management of a government-owned enterprise. Government companies can be converted into private companies in two ways:

- By Disinvestment
- By Withdrawal of governmental ownership and management of public sector companies.

Forms of Privatization

- **Denationalization or Strategic Sale:** When 100% government ownership of productive assets is transferred to the private sector players, the act is called denationalization.
- **Partial Privatization or Partial Sale:** When private sector owns more than 50% but less than 100% ownership in a previously construed public sector company by transfer of shares, it is called partial privatization. Here the private sector owns the majority of shares. Consequently, the private sector possesses substantial control in the functioning and autonomy of the company.

- **Deficit Privatization or Token Privatization:** When the government disinvests its share capital to an extent of 5-10% to meet the deficit in the budget is termed as deficit privatization.

Objectives of Privatization

- Improve the financial situation of the government.
- Reduce the workload of public sector companies.
- Raise funds from disinvestment.
- Increase the efficiency of government organizations.
- Provide better and improved goods and services to the consumer.
- Create healthy competition in the society.
- Encouraging foreign direct investments (FDI) in India.

Globalization

It means to integrate the economy of one country with the global economy. During Globalization the main focus is on foreign trade & private and institutional foreign investment. It is the last policy of LPG to be implemented.

Globalization as a term has a very complex phenomenon. The main aim is to transform the world towards independence and integration of the world as a whole by setting various strategic policies. Globalization is attempting to create a borderless world, wherein the need of one country can be driven from across the globe and turning into one large economy.

Outsourcing as an Outcome of Globalization

The most important outcome of the globalization process is Outsourcing. During the outsourcing model, a company of a country hires a professional from some other country to get their work done, which was earlier conducted by their internal resource of their own country.

The best part of outsourcing is that the work can be done at a lower rate and from the superior source available anywhere in the world. Services like legal advice, marketing, technical support, etc. As the Information Technology has grown in the past few years, the outsourcing of contractual work from one country to another has grown tremendously. As a mode of communication has widened their reach, all economic activities have expanded globally.

Various Business Process Outsourcing companies or call centres, which have their model of a voice-based business process have developed in India. Activities like accounting and book-keeping services, clinical advice, banking services or even education are been outsourced from developed countries to India.

The most important advantage of outsourcing is that big multi-national corporate or even small enterprises can avail good services at a cheaper rate as compared to their country's standards. The skill set in India is considered most dynamic and effective across the world. Indian professionals are best at their work. The low wage rate and specialized personnel with high skills have made India the most favourable destination for global outsourcing in the later stage of reformation.

LPG Model in India

After Independence in 1947 Indian government faced a significant problem to develop the economy and to solve the issues. Considering the difficulties pertaining at that time government decided to follow LPG Model. The Growth Economics conditions of India at that time were not very good. This was because it did not have proper resources for the development, not regarding natural resources but financial and industrial development. At that time India needed the path of economic planning and for that used 'Five Year Plan' concept of which was taken from Russia and feet that it will provide a fast development like that of Russia, under the view of the socialistic pattern society. India had practiced some restrictions ever since the introduction of the first industrial policy resolution in 1948.

Liberalization is defined as making economics free to enter the market and establish their venture in the country. **Privatization** is defined as when the control of economic is sifted from public to a private hand. **Globalization** is described as the process by which regional economies, societies, and cultures have become integrated through a global network of communication, transportation, and trade.

Factors of Country Evaluation and Selection

Country Evaluation and Selection: Tool #1

Trade Analysis and Analogy Methods:

Trade analysis and country analogy methods are widely used for country evaluation by estimating their market size. In simple terms, the market size of a country may be determined by subtracting the exports of a product from the sum-total of its production and imports.

Market size = Production + Imports – Exports

One can arrive at market size by using data based on ITC(HS) code classifications up to eight digits for specific product categories. Published data on exports and imports can be obtained through international sources, such as the WTO, International Trade Centre, and the UNCTAD.

National governments comply trade statistics through customs and central banks, for instance, in India, through DGCI&S and Reserve Bank of India (RBI).

Production statistics are generally available through government organizations for broad product categories, such as agricultural commodities, textiles, steel, cement, minerals, etc. More product-specific statistics are compiled by commodity organizations and trade associations.

For new product categories, with little consumption and production in the past, various types of analogy methods are employed. In the analogy method, a country at similar stage of economic development and comparable consumer behaviour is selected whose market size is known.

Besides, a surrogate measure is also identified, which has similar demand to the product for the international market. Alternatively, the analogy method for different time periods, which may be compared with similar demand patterns in two different countries, may also be used.

Country Evaluation and Selection: Tool #2

Opportunity-Risk Analysis:

Carrying out a cross-country analysis of opportunities and risks provides a useful tool to compare and evaluate various investment locations based on a company's objectives and business environment. The internationalizing firm may choose variables both for opportunities (such as market size, growth, future potential, tax regime, costs, etc.) and risks (political, economic, legal, operational, etc.).

Values and weights may be assigned to each of these variables depending upon their perceived significance by the firm. Thus, it provides an opportunity to a company to evaluate each country on the weighted indicators.

On the basis of business opportunities and risks, ranking of various countries may be made for investment. Countries with low-risks and high-returns are often preferred investment destinations. In addition, such grids may also be used for future projections.

Although, such grids (Exhibit 10.2) serve as useful tools for cross-country comparison of opportunity versus risk, it hardly provides any insight into relationships among the investment destinations.

Exhibit 10.2 Opportunity–risk grid for cross-country evaluation

Variable	Weight		Country		
		A	B	C	D
Opportunities					
▪ Market size					
▪ Growth					
▪ Competitive intensity					
▪ Operations costs					
▪ Marketing efficiency					
▪ Tax rates					
Total					
Risks					
▪ Political					
▪ Commercial					
▪ Economic					
▪ Operational					
Total					

Countries for investment can also be plotted in form of a matrix, as shown in Fig. 10.23, to indicate opportunities and risks. Besides, the countries can be placed for a pre-defined future time, both for opportunities and risks. In addition to inter-country evaluation, the country placements and its benchmarking with the global average opportunities and risks may also be carried out.

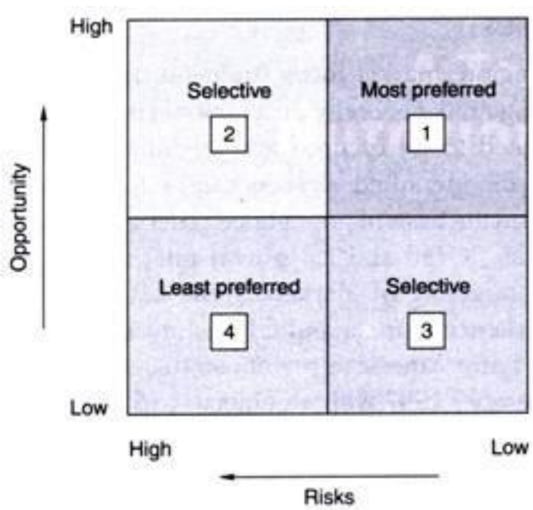

Fig. 10.23 Opportunity–risk matrix for country evaluation

Country Evaluation and Selection: Tool #3

Products-Country Matrix Strategy:

With an objective to examine market diversification and commodity diversification, the product-country matrix strategy is employed. Under this approach, previous trade statistics are analysed to identify the major markets and major products, based on which a suitable marketing strategy is developed.

The matrix based on a predominantly supply side analysis reveals comparative advantages. In 1995, the Government of India carried out the analysis of trade data of the mid-nineties to prepare such a matrix. The analysis revealed the restricted commodity/country basket for India's exports.

It was observed that 15 countries and 15 commodities accounted for around 75-80 per cent of India's exports. An attempt was made to involve trade and industry to set up trade facilitators for achieving increased exports in the 15 products and 15 markets.

However, the exercise of the trade facilitation did not get enough support and response from various stakeholders. The focus on the 15 x 15 matrix, based on past performance data was a useful exercise as it helped to focus on the importance of a few commodities and a few destinations in India's export performance.

There has been a market diversification for the top products though there has also been a product consolidation for the top markets. The analysis also reveals that the 15 X 15 matrix is dynamic and mature as it has undergone changes over the years and it requires modification of marketing strategy on a continuous basis.

Country Evaluation and Selection: Tool #4

Market Focus Strategies:

In view of market potential of a region, market focus strategies can be formulated. Under this technique, the market potential, generally on a regional basis is determined and major product groups that need to be focused are identified. Subsequently, strategies for increasing exports to the identified markets can be formulated.

India's major markets have been identified on the basis of pre-defined criteria, such as country's share in imports and its growth rate, GDP and its growth rate, and trade deficits which facilitate segmentation and targeting of markets. India has formulated such market focus strategies for Latin America, Africa, and CIS countries.

Considering the potential of the Latin American region, an integrated programme 'Focus LAC was launched in November 1997 with an objective to focus at the Latin American region, with added emphasis on the nine major trading partners of the region.

The strategy emphasized identification of areas of bilateral trade and investments so as to promote commercial interaction. This region, comprising 43 countries, accounted for about

5 per cent of the world trade. But India is not a significant trading partner of this region. Under the programme, nine major product groups for enhancing India's exports to the Latin American region were identified.

These included:

1. Textiles including ready-made garments, carpets, and handicrafts
2. Engineering products and computer software
3. Chemical products including drugs/pharmaceuticals.

On similar lines, Focus Africa was launched on 1 April 2002, which initially covered seven countries in the first phase of the programme to include Nigeria, South Africa, Mauritius, Kenya, Tanzania, and Ghana.

Subsequently, it was extended to 11 other countries of the region, i.e., Angola, Botswana, Ivory Coast, Madagascar, Mozambique, Senegal, Seychelles, Uganda, Zambia, Namibia, and Zimbabwe along with the six countries of North Africa—Egypt, Libya, Tunisia Sudan, Morocco, and Algeria.

Focus CIS was launched on 1 April 2003, which include focused export promotion to 12 CIS (commonwealth of independent states) countries, i.e., Russian Federation, Ukraine, Moldova, Georgia, Armenia, Azerbaijan, Belarus, Kazakhstan, Uzbekistan, Kyrgyzstan, Turkmenistan, and Tajikistan—the Baltic states of Latvia, Lithuania, and Estonia.

The programme was based on an integrated strategy to focus on major product groups, technology and services sectors for enhancing India's exports and bilateral trade and co-operation with countries of the CIS region.

The strategy envisaged at making integrated efforts to promote exports by the Government of India and various related agencies, such as India Trade Promotion Organisation (ITPO), Export Promotion Councils (EPCs), Apex Chambers of Commerce and Industry, Indian missions abroad, and institutions such as Export Import Bank and Export Credit and Guarantee Corporation (ECGC).

Such integrated and focused approaches are conceptually sound but their success depends upon effectiveness of implementation of the programmes. On 1 April 2006, the Focus Market Scheme was launched in order to enhance the competitiveness in the select markets. The scheme notifies 83 countries form Latin America, Africa, and CIS.

Country Evaluation and Selection: Tool #5

Growth-Share Matrix:

The technique offers a useful tool to evaluate countries for different product categories based on their market share and growth rate. Products are classified under four categories on the lines of BCG matrix based on a model developed by Boston Consulting Group for classification of strategic business units (SB Us) of an organization, as shown in Fig. 10.24.

Such a matrix can be prepared either for country's exports or firm's exports so as to facilitate segmentation of the products under the broad categories:

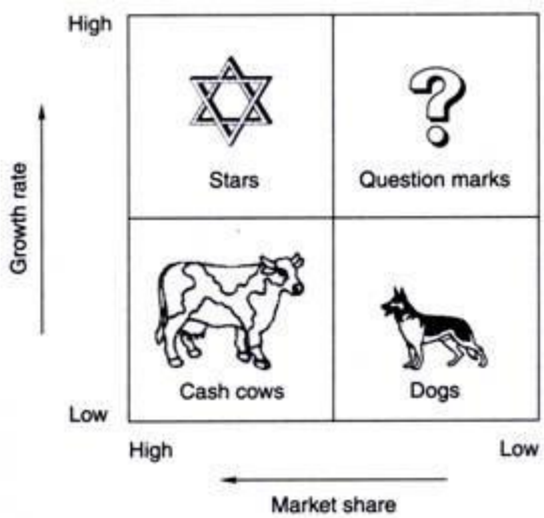

Fig. 10.24 Growth–share (BCG) matrix

High-growth high-share [stars] products:

Such products offer high-growth potential but require lot of resources to maintain the share in high-growth markets.

Low-growth high-share [cash cows) products:

Products under this category bring higher profits, although have a slow market growth rate.

High-growth low-share [question marks) products:

These are the products under high risk category with an uncertain future, sometimes called problem children. A highly competitive strategic business decision is required to invest resources to bring it to the category of stars by achieving a higher market share.

Low-growth Low-share (dogs) products:

These products have low growth and low market share, therefore generally do not call for investing much resources.

For each of the product groups under the growth share matrix, differentiated strategies need to be formulated and adopted. Similar matrix can also be prepared country-wise for formulating country-specific business strategies.

Country Evaluation and Selection: Tool #6

Country Attractiveness-Company Strength Matrix:

An analysis may be carried out for country evaluation and strategy development based on business attractiveness of countries and the competitive strength of the company.

Various factors, such as market size, market growth, customers' buying power, average trade margins, seasonality and fluctuations in the market, marketing barriers, competitive structures, government regulations, economic and political stability, infrastructure, and psychic distance may be taken into account to assess the country attractiveness.

The competitive strength of a firm is often determined by its market share, familiarity and knowledge about the country, price, product-fit to the market, demands, image, contribution margin, technology position, product quality, financial resources, access to distribution channels, and their quality.

An analysis can be carried out in the form of a matrix, assigning weight to each of these factors. Based on this analysis, a matrix may be drawn as in Fig. 10.25.

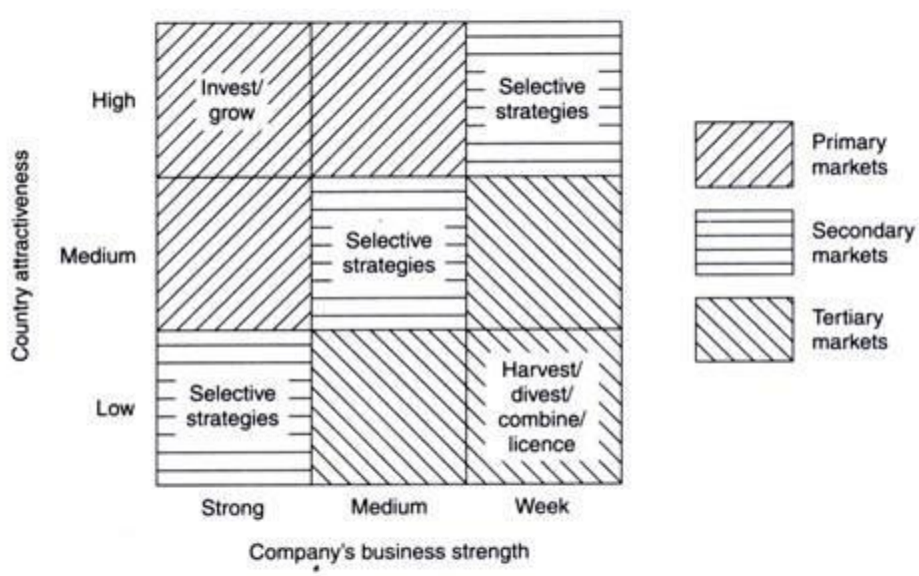

Fig. 10.25 Country attractiveness–company strength matrix

The countries depicted in the matrix may be segmented as

Primary Markets:

These countries offer the highest marketing opportunities and call for a high level of business commitments. The firms often strive to establish permanent presence in these countries.

Secondary Markets:

In these countries, the perceived political and economic risks are too high to make long-term irrevocable business commitments. A firm has to explore and identify the perceived risk factors or the firm's limitations in these countries and adopt individualized strategies, such as joint ventures so as to take care of the limitations of operating business.

Tertiary Markets:

These are countries with high perceived risks; therefore, allocation of firm's resources is minimal. Generally a firm does not have any long-term commitment in such countries and opportunistic business strategies such as licensing are often followed.

Based on the above analysis, a firm should focus its country selection and expansion strategies in countries at the top left of the matrix where the country attractiveness and the competitive strengths of the company are very high. On the other hand, the firm should focus on harvesting/divesting its resources from countries where the country attractiveness and company strength both are very low.

However, a firm may use licensing as a mode of business operation with little resource commitment but continue to receive royalties. Countries at the extreme right top of the matrix signify higher country attractiveness but lower company strength.

A firm should identify its competitive weaknesses in these countries and strive to gain the competitive strength. It may also enter into joint venture with other firms, which most of the time are local and have complementarities to gain competitive strength.

In countries where a firm has medium competitive strength and country attractiveness needs to carefully study the market condition and adopt appropriate strategy. Ford tractors used the country attractiveness-company strength matrix and placed India under the extreme right top of the matrix wherein the country attractiveness was very high but the competitive strength of the company was low.

Decisions to expand business across national boundaries require much higher level of commitment of a company's resources as any business failure may have serious repercussions. By way of effective evaluation and selection of countries, the internationalizing firm avoids wastage of time and resources and it can focus its efforts on a few fruitful locations.

Decision Concerning Foreign Direct and Portfolio

Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI) are the two important forms of foreign capital. The real difference between the two is that while FDI aims to take control of the company in which investment is made, FPI aims to reap profits by investing in shares and bonds of the invested entity without controlling the company.

Both FDI and FPI are the most well sought type of foreign capital by the developing world. Usually, both these are measured in terms of the percentage of the shares they own in a company (ie., 10%, 20% etc.,).

According to the existing regulation by the SEBI, FPI is investment in shares of a company not exceeding 10% of the total paid up capital of the company. Any investment above 10% is FDI as with that size of shareholding, the foreign investor can exert control in the management of the company.

A marvellous advantage of both FDI and FPI is that the receiving country need not repay the debt like in the case of External Commercial Borrowings (foreign loans). Both are thus described as non –debt creating, and hence involve no payment obligations. Their own servicing depends on future growth of the economy. This is why most developing countries prefer FDI and FPI compared to other forms of foreign capital like ECBs.

The similarity between the two ends here. A one-to one comparison will reveal that FDI is superior to FDI from the angle of a developing country like India.

Foreign Direct Investment (FDI)

FDI is investment by non-resident entities like MNCs to carryout business operations in India with management of investment, production of goods or services, employing people and marketing their products. In FDI, both the ownership and control of the firm is with the investor. The foreign investor usually takes a considerable stake or shareholding in the company and exerts management influences completely or partially, depending on his shareholding.

Foreign Portfolio Investment (FPI)

FPI on the other hand is investment in shares, bonds, debentures, etc. According to the IMF, portfolio investment is defined as cross-border transactions and positions involving debt or equity securities, other than those included in direct investment or reserve assets.

FDI vs. FPI: Of the two, FDI is more desirable

FDI means real investment; whereas FPI is monetary or financial investment –Here, FDI means the investor makes investment in buildings and machineries directly in the company in which he has made the investment. FPI doesn't create such productive asset creation directly. It is just financial investment. FDI is certain, predictable, takes production risks, have stabilizing impact on production. It directly augments employment, output, export etc. The major merit of FDI is that it is non debt creating as well as non-volatile (less fluctuating).

FPI on the other hand is investment aimed at getting profits from shares, interests from deposits etc. It is otherwise known as hot money. The portfolio investors stays his money in the capital market only for a short period of time. Its destination period is so small and is empirically considered as fluctuating (often short term) capital. It is highly volatile, a fair weather friend, speculative, involves exchange risks and may lead to capital flight and currency crisis affecting real economic variables. It is destabilizing in the foreign exchange market. Fluctuations in the mobility of FPI affects foreign exchange rate, domestic money supply, value of rupee, call money rates, security market etc. FII (Foreign Institutional Inflows) inflows depend on two factors: first, return potential of the destination market (host country) and second availability of risk capital at source geographies (home market; countries like the US). A change in environment in any of these will result in quick reversal of the flows.

If FDI is certain, long term and less fluctuating, FPI is speculative, highly volatile and un-predictive. Hence, FDI is superior to FPI.