A Global Village

The world is fast becoming a global village where there are no boundaries to stop free trade and communication. Keeping pace with it, the way we do business has changed in an unprecedented manner. The competition, in the global marketplace, is at its peak where all companies want to sell their goods to everyone, everywhere on the globe.



For example, the faucet we see in our bathroom may be from Italy. The towels we use may be a Brazilian product. The automobile we drive may be a Japanese or German brand. The air conditioners we use may be from France. It is almost impossible to stay isolated and be self-sufficient in this day and age. That is why multinational companies are a reality.

What is International Business?

Any business that involves operations in more than one country can be called an international business. International business is related to the trade and investment operations done by entities across national borders.

Firms may assemble, acquire, produce, market, and perform other value-addition-operations on international scale and scope. Business organizations may also engage in collaborations with business partners from different countries.

Apart from individual firms, governments and international agencies may also get involved in international business transactions. Companies and countries may exchange different types of physical and intellectual assets. These assets can be products, services, capital, technology, knowledge, or labor.

**Note** − In this tutorial, we are primarily focusing towards business operations of the individual firm.

Internationalization of Business

Let’s try to explore the reasons why a business would like to go global. It is important to note that there are many challenges in the path of internationalization, but we’ll focus on the positive attributes of the process for the time-being.

There are five major reasons why a business may want to go global −

* **First-mover Advantage** − It refers to getting into a new market and enjoy the advantages of being first. It is easy to quickly start doing business and get early adopters by being first.
* **Opportunity for Growth** − Potential for growth is a very common reason of internationalization. Your market may saturate in your home country and therefore you may set out on exploring new markets.
* **Small Local Markets** − Start-ups in Finland and Nordics have always looked at internationalization as a major strategy from the very beginning because their local market is small.
* **Increase of Customers** − If customers are in short supply, it may hit a company’s potential for growth. In such a case, companies may look for internationalization.
* **Discourage Local Competitors** − Acquiring a new market may mean discouraging other players from getting into the same business-space as one company is in.

Advantages of Internationalization

There are multiple advantages of going international. However, the most striking and impactful ones are the following four.

Product Flexibility

International businesses having products that don’t really sell well enough in their local or regional market may find a much better customer base in international markets. Hence, a business house having global presence need not dump the unsold stock of products at deep discounts in the local market. It can search for some new markets where the products sell at a higher price.

A business having international operations may also find new products to sell internationally which they don’t offer in the local markets. International businesses have a wider audience and thus they can sell a larger range of products or services.

Less Competition

Competition can be a local phenomenon. International markets can have less competition where the businesses can capture a market share quickly. This factor is particularly advantageous when high-quality and superior products are available. Local companies may have the same quality products, but the international businesses may have little competition in a market where an inferior product is available.

Protection from National Trends and Events

Marketing in several countries reduces the vulnerability to events of one country. For example, the political, social, geographical and religious factors that negatively affect a country may be offset by marketing the same product in a different country. Moreover, risks that can disrupt business can be minimized by marketing internationally.

Learning New Methods

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

Globalization

Although globalization and internationalization are used in the same context, there are some major differences.

* Globalization is a much larger process and often includes the assimilation of the markets as a whole. Moreover, when we talk about globalization, we take up the cultural context as well.
* Globalization is an intensified process of internationalizing a business. In general terms, global companies are larger and more widespread than the low-lying international business organizations.
* Globalization means the intensification of cross-country political, cultural, social, economic, and technological interactions that result in the formation of transnational business organization. It also refers to the assimilation of economic, political, and social initiatives on a global scale.
* Globalization also refers to the costless cross-border transition of goods and services, capital, knowledge, and labor.

Factors Causing Globalization of Businesses

There are many factors related to the change of technology, international policies, and cultural assimilation that initiated the process of globalization. The following are the most important factors that helped globalization take shape and spread it drastically.

The Reduction and Removal of Trade Barriers

After World War II, the General Agreement on Tariffs and Trade (GATT) and the WTO have reduced tariffs and various non-tariff barriers to trade. It enabled more countries to explore their comparative advantage. It has a direct impact on globalization.

Trade Negotiations

The Uruguay Round of negotiations (1986–94) can be considered as the real boon for globalization. It is considerably a large set of measures which was agreed upon exclusively for liberalized trade. As a result, the world trade volume increased by 50% in the following 6 years of the Uruguay Round, paving the way for businesses to span their offerings at an international level.

Transport Costs

Over the last 25 years, sea transport costs have plunged 70%, and the airfreight costs have nosedived 3–4% annually. The result is a boost in international and multi-continental trade flows that led to Globalization.

Growth of the Internet

Expansion of e-commerce due to the growth of the Internet has enabled businesses to compete globally. Essentially, due to the availability of the Internet, consumers are interested to buy products online at a low price after reviewing best deals from multiple vendors. At the same time, online suppliers are saving a lot of marketing costs.

Growth of Multinational Corporations

Multinational Corporations (MNCs) have characterized the global interdependence. They encompass a number of countries. Their sales, profits, and the flow of production is reliant on several countries at once.

The Development of Trading Blocs

The 'regional trade agreement' (RTA) abolished internal barriers to trade and replaced them with a common external tariff against non-members. Trading blocs actually promote globalization and interdependence of economies via trade creation.

# Country Attractiveness

The International business environment includes various factors like social, political, regulatory, cultural, legal and technological factors that surround a business entity in various sovereign nations. There are **exogenous factors** relative to the home environment of the organization in the international environment. These factors influence the decision-making process on the use of resources and capabilities. They also make a nation either more or less attractive to an international business firm.

We will take up the most important factors and see how they affect the operational process of a business.

Adapting to Changing Needs

Firms do not have any control over the external business environment. Therefore, the success of an international company depends upon its ability to adapt to the overall environment.

Its success also depends on the ability to adjust and manage the company’s internal variables to leverage on the opportunities of the external environment. Moreover, the company’s capability to control various threats produced by the same environment, also determines its success.

A term called ‘country attractiveness’ is often discussed in the international business fraternity. It is important to consider attractiveness before we move on to discuss environmental factors.



Country Attractiveness

Country attractiveness is a measure of a country’s attractiveness to the international investors. In international business, investment in foreign countries is the most important aspect and hence firms want to determine how suitable a country is in terms of its external business environments.

International business firms judge the risks and profitability of doing business in a particular country before investing and starting a business there. This judgment includes studying the environmental factors to arrive at a decision.

It is pretty clear that businesses prefer a country that is less costly, more profitable, and has fewer risks. Cost considerations are related with investment. Profitability is dependent on resources. Risks are associated with the environment and hence it is of prime concern.

Risks may be of various types. However, the general consensus is that a country that is more stable in terms of political, social, legal, and economic conditions is more attractive for starting a business.

Business Environments

There are numerous types of business environments, however the political, the cultural, and the economic environments are the prime ones. These factors influence the decision-making process of an international business firm. It is important to note that the types of environments we discuss here are interlinked; meaning one’s state affects the others in varying dimensions.

The Political Factors

The political environment of a nation affects the legal aspects and government rules which a foreign firm has to experience and follow while doing business in that nation. There are definite legal rules and governance terms in every country in the world. A foreign company that operates within a particular country has to abide by the country’s laws for the duration it operates there.

Political environment can affect other environmental factors −

* Political decisions regarding economy can affect economic environment.
* Political decisions may affect the socio-cultural environment of a nation.
* Politicians may affect the rate of emergence of new technologies.
* Politicians can exert influence in the acceptance of emerging technologies.

There are four major effects of political environment on business organizations −

* **Impact on Economy** − The political conditions of a nation have a bearing on its economic status. For example, Democratic and Republican policies in the US are different and it influences various norms, such as taxes and government spending.
* **Changes in Regulation** − Governments often alter their decisions related to business control. For example, accounting scandals in the beginning of the 21st century prompted the US SEC turn more mindful on the issues of corporate compliance. Sarbanes-Oxley compliance regulations (2002) were social reactions. The social environment demanded the public companies to be more responsible.
* **Political Stability** − Political stability effects business operations of international companies. An aggressive takeover overthrowing the government could lead to a disordered environment, disrupting business operations. For example, Sri Lanka’s civil war and Egypt and Syria disturbances were overwhelming for businesses operating there.
* **Mitigation of Risk** − There are political risk insurance policies that can mitigate risk. Companies with international operations leverage such insurances to reduce their risk exposure.

**Note** − You can check [The Index of Economic Freedom](http://www.heritage.org/index/). It ranks and compares the countries depending on how politics impacts business-decisions in those locations.

The Economic Factors

Economic factors exert a huge impact on international business firms. The economic environment includes the factors that influence a country's attractiveness for international business firms.

* Business firms seek **predictable, risk-free, and stable mechanisms**. Monetary systems that acknowledge the relative dependence of countries and their economies are good for a firm. If an economy fosters growth, stability, and fairness for prosperity, it has a positive effect on the growth of companies.
* Inflation contributes hugely to a country's attractiveness. High rate of inflation increases the cost of borrowing and makes the revenue contract in domestic currency. It exposes the international firms to foreign-exchange risks.
* Absolute purchasing power parity is also an important consideration. The ratio of exchange rate between two particular countries is identical to the ratio of the price levels. The law of one price states that the real price of a product is same across all nations.
* Relative purchasing power parity (PPP) is valuable for foreign firms. It asks how much money is needed to buy the same goods and services in two particular countries. PPP rates prompt international comparisons of income.

The Cultural Factors

Cultural environments include educational, religious, family, and social systems within the marketing system. Knowledge of foreign culture is important for international firms. Marketers who ignore cultural differences risk failure.

* **Language** − There are nearly 3,000 languages in the world. Language differences are important in designing advertising campaigns and product labels. If a country has several languages, it may be problematic.
* **Colors** − It is important to know how people associate with colors. For example, purple is unacceptable in Hispanic nations because it is associated with death.
* **Customs and Taboos** − It is important for marketers to know the customs and taboos to learn what is acceptable and what is not for the marketing programs.
* **Values** − Values stem from moral or religious beliefs and are acquired through experiences. For example, in India, the Hindus don’t consume beef, and fast-food restaurants such as McDonald's and Burger King need to modify the offerings.
* **Aesthetics** − There are differences in aesthetics in different cultures. Americans like suntans, the Japanese do not.
* **Time** − Punctuality and deadlines are routine business practices in the U.S. However, Middle East and Latin American people are far less bound by time constraints.
* **Religious Beliefs** − Religion can affect a product’s labelling, designs, and items purchased. It also affects the consumers' values.

**Cultural Differences**

* Ireland’s evening meal is called tea, not dinner.
* If you nod in Bulgaria, it means "no" and moving the head from one side to the other means "yes".
* Pepsodent toothpaste did not sell well in Southeast Asia, as it promised white teeth. Black or yellow teeth are symbols of prestige there.

# Protectionism

**Protectionism** is a policy of protecting the domestic businesses from foreign competition by applying tariffs, import quotas, or many types of other restrictions attached to the imports of foreign competitors’ goods and services.

There are many protectionist policies in place in many nations despite the fact that there is a popular consensus that the world economy, as a whole, benefits from free trade.

* **Government-levied tariffs** − The best form of protectionist measure is the government-levied tariffs. The common practice is raising the price of the imported products so that they cost more and hence become less attractive than the domestic products. There are many believers that protectionism is a helpful policy for the emergent industries in the developing nations.
* **Import quotas** − Import quotas are the other forms of protectionism. These quotas limit the amount of products imported into a country. This is considered to be a more effective strategy than protective tariffs. Protective tariffs do not always repel the consumers who are ready to pay higher prices for imported goods.
* **Mercantilism** − Wars and recessions are the major reasons behind protectionism. On the other hand, peace and economic prosperity encourage free trade. In 17th and 18th centuries, the European monarchies used to rely heavily on protectionist policies. This was due to their aim to increase trade and improve the domestic economies. These (currently discredited) policies are called mercantilism.
* **Reciprocal trade agreements** − Reciprocal trade agreements limit the protectionist measures in lieu of eliminating them fully. However, protectionism still exists and is heard when economic hardships or joblessness is aggravated by foreign competition.



Currently, protectionism is in a unique form. Economists term the form as **administered protection**. Most rich nations have fair trade laws. The announced purpose of Free Trade Laws is twofold −

* First is to make sure that foreign countries do not subsidize exports so that market incentives are not distorted and hence efficient allocation of activity among the countries is not destroyed.
* The second purpose is to assure that international companies do not dump their exports in an aggressive manner.

These mechanisms are meant to augment free trade.

**End of Protectionism in History**

Great Britain started to end the protective tariffs in the first half of the 19th century after achieving industrial leadership in Europe. Britain’s removal of protectionist measures and acceptance of free trade was symbolized by the repeal of the Corn Laws (1846) and various other duties on imported grains.

Europe’s protectionist policies became relatively mild in the latter half of the 19th century. However, France, Germany, and many other nations imposed customs duties to shelter the improving industrial belts from British competition. Customs duties fell sharply in Western world by 1913, and import quotas were almost never used.

The damage and displacement in World War I inspired an increasing raise of customs barriers in Europe in the 1920s. Great Depression of the 1930s resulted in record levels of unemployment which led to an epidemic of protectionism.

The United States was also a protectionist country, and the levied tariffs reached the top during 1820s and the Great Depression. The Smoot-Hawley Tariff Act (1930) raised the average tariff on imported goods by about 20 percent.

US protectionist policies started getting vanished by the middle of the 20th century. By 1947, the United States became one of the 23 nations to sign reciprocal trade agreements (the General Agreement on Tariffs and Trade - GATT). GATT, which was amended in 1994, was taken over by the World Trade Organization (WTO) in Geneva (1995). WTO negotiations have led to reduced customs tariffs by most of the major trading nations.

# Liberalization

Liberalization Vs Deregulation

**Liberalization** is the process of relaxation from government control. It is a very important economic term. Technically, it means the reductions in applied restrictions of the government on international trade and capital. Liberalization is also used in tandem with another term − Deregulation.

**Deregulation** is the disappearance of state restrictions on both domestic and international business. However, in principle, the two terms are distinct because liberalized markets are often subject to government regulations for various reasons, such as consumer protection. But in practice, both terms generally refer to the removal of state intervention in markets.



Arguments, Counterarguments, and Discussions

The advantages of liberalization and deregulation are questioned in many ways. Both of these phenomena are related with the “Washington consensus.” The consensus is a set of market-related policy prescriptions supported by neoliberals for economic growth of developing countries. Critics, however, argue that the policies are used to exploit poorer workers by corporations from rich countries.

Activists and scholars alike somewhat agree that markets are, in reality, neither truly free nor fair. For example, there are subsidies paid by the government to cotton producers in the United States and the European Union. This, in reality, artificially drives the prices down, putting African cotton farmers in an uncomfortable state.

Critics note that the issue is not about the freeing of markets per se but, rather, that the companies of wealthier countries are manipulating the term to their own benefits at large.

Liberalization, Privatization, and Globalization

Due to close resemblance and similar attributes, the term LPG (Liberalization, Privatization, and Globalization) is generally used nowadays to describe the phenomena of freeing up of markets.

Although the three terms are distinct and have their own attributes, it is particularly helpful to describe the contemporary and new market conditions of 21st century through the term LPG. In fact, liberalization is the gateway to globalizations and hence, when we talk about the benefits of globalization, it is always a manifestation of the process of liberalization.

It is impossible to consider the business aspects without having a global view in many of the scenarios and hence, LPG is a way to deal with the latest marketing and operational trends in international marketing.

Revolutionary Economic Trends

Liberalization and deregulation stimulated the epic run of three major areas of business −

* International trade grew at an average rate of 6% annually between 1948 and 1997.
* FDI was impacted too, which saw the stocks and inflows exceed the rise in world trade.
* Foreign exchange markets achieved an average daily turnover reaching trillions of dollars.

Liberalization and deregulation contributed heavily to the globalization of the world economy.

# General Agreements On Tariffs & Trade

In the 18th and 19th century, almost all nations and nation-states believed that protectionism is a must for the well-being of domestic economies. However, with passing time, this idea started to change. The idea of liberalizations and thereby abolishment of protectionist measures peaked in the middle half of the 20th century. The epitome of liberalism took the first palpable shape as GATT, which was later replaced by the WTO.

## General Agreements on Tariffs and Trade

General Agreement on Tariffs and Trade (GATT) includes some multilateral trade agreements formed to abolish the quotas and reduce various tariffs among the participating nations. GATT was formed by 23 countries signing the agreement at Geneva, in 1947. It was aimed to offer an interim arrangement which could be replaced by a United Nations agency soon.

GATT played a hero’s role in expanding the world trade in the latter half of the 20th century. 125 nations had already become signatories to GATT when it was replaced by the WTO in 1995.

## GATT – Major Principles

GATT’s major principle was **trade without discrimination**. The participating nations opened the markets impartially to every other member. According to GATT, once a nation and its largest trade allies had agreed to reduce a tariff, that reduction automatically became applicable to all other GATT members.

* GATT preferred **protection through tariffs** and by leveraging on it, GATT systematically tried to eliminate the import quotas or other quantitative trade restrictions.
* GATT also had **homogenous customs regulations** and the obligation of the participating nations in negotiating for tariff reductions on any other nation’s request.
* The **escape clause** was also in place for contracting nations to modify the agreements when their domestic producers suffered excessive losses due to the trade concessions.

## Role of GATT in Promoting International Trade

GATT’s role was instrumental in the following aspects −

* GATT formulated standards to direct the contracting nations to take part in international trade. As mentioned above, GATT stipulated some basic principles for the contracting parties.
* GATT cut tariffs for the mutual benefit of an accelerated trade liberalization. There was a palpable reduction, about 35% on average, in both Kennedy and Tokyo Rounds.
* GATT brought discrimination in tariff down to promote reducing other trade barriers. GATT had regulated that the participating nations cannot increase tariffs at will.
* GATT, in its progressive days, tried to protect the desires of the developing countries in terms of international trade. It established some special measures, including the tariff protection for select industries. GATT made sure that the developing countries got a preferential treatment.

Finally, GATT was the “court of international trade.” Settling the disputes between two or more parties was one of its primary objectives. GATT had become a legal guardian of nations for settling trade disputes.

# World Trade Organization

The World Trade Organization (WTO) is the single global international organization dealing with the rules related to international trade. WTO’s agreements are negotiated and signed by a majority of prominent trading nations. The agreements are ratified in the parliaments of the contracting countries.

Reasons behind the Formation of WTO

On 1st January, 1995, the World Trade Organization replaced GATT. The reasons for GATT being replaced by the WTO are the following.

* GATT was only a provisional arrangement. It lacked the qualities of an international covenant, and it could not ensure the enforcement mechanisms. GATT could do nothing in case of a bilateral trade-agreement failure. There were rules set for enforcement by GATT, but there was no mechanism for its application.
* GATT’s jurisdiction was applicable only to product-transactions. Due to globalization, services and technologies became a major part of international investments and trade.
* Limitations and restriction on dispute settlement systems of GATT also made it vulnerable to challenges. GATT required a fully positive consensus in the GATT Council to propose the dispute to the panel. Many countries often objected in dispute settlement cases related to discrimination.
* Moreover, GATT’s rules were not sufficiently strict and their execution was very hard to practice. Many participating parties tried to bend the rules of GATT in their self-interests, and GATT could not verify and inspect these issues.
* Finally, there were some influences of powerful nations in some historical multilateral rounds. Starting from the Geneva Round till the Uruguay Round, national sovereignty was present in the multilateral negotiation rounds.

The WTO was a natural demand of the times for a holistic development of economies.



Role of WTO in Promoting International Trade

WTO promotes business liberalization and economic globalization. It has implemented a substantial decline in tariff levels.

WTO members experienced an average of 40% decline in tariff rate. Agriculture industry and textile trade expansions, security enhancement, anti-dumping and countervailing, dispute-free investment and trade in services and intellectual properties have been the most significant achievements of the WTO.

**WTO STATISTICS**

In 1999, tariff rate in developed countries dropped from 6.3% to 3.9%. Imported duty-free manufactured goods increased from 20% to 43%, and tariffs on imported manufactured goods reduced to 5% on average.

WTO plays a major role in promoting peace among the countries. WTO lets international trade and investment to run smoothly. Countries also get a constructive and fair institution for dealing with disputes over trade issues due to the presence of the WTO.

The WTO also plays a role in decreasing the cost of living. Protectionism increases the cost of the goods. WTO lowers the trade barriers via negotiation and through its non-discrimination policy.

Role of Developing Countries

Developing countries usually don’t have the muscle to negotiate in the international markets and they need to follow the developed countries’ terms. WTO’s Most favored Nation (MFN) principle, which allows market liberalization, helps the developing nation to trade and prosper. Besides, it also supports the multilateral framework for rules and agreement.

Developing countries benefit from the intellectual property rules of WTO. **Trade-Related Aspects of Intellectual Property Rights** (TRIPS) agreement offers a suitable policy framework that helps to promote technology transfer and FDI flow to developing nations.

There are some preferential treatments available for the developing countries too. **Generalized System of Preferences** (GSP) enables non-reciprocal preferential treatment by developed countries.

WTO offers flexibility to developing countries to implement their TRIPS obligation, especially those that are adopted in the Uruguay round. It helps in holistic improvement of developing nations.

# Global Trade - Major Challenges

Global trade and investment or broadly, **globalization,** is a common market condition for all countries of the world now. However, it is not free from challenges. To be specific, there are seven major challenges to global trade and investment the world is facing now.

### Economic Warfare

Globalization has a tough challenge against polarization and conflicting issues. The world is experiencing increased conflicts, major economic powers are seizing influence, financial sanctions are being used as a weapon, and the Internet is breaking into pieces. Therefore, the international flow of money, information, products and services may slow down.

### Geo-politicization

Globalization is a kind of Americanization. The United States is still a dominating economy and the hallmark of the international financial system. Moreover, information age is promoting the democratization of information. It is paving the way for demanding more information and the autocrats now need to care more about public opinion. The developments of developing countries are making them more or less like America.

### State Capitalism

The United States was a strong nation in the last quarter of the century. But now, state capitalism in a modern form is gripping many nations. This is creating new segments in the markets and destroying the uniformity expected from globalization. Now, there is nothing predominantly American or about globalization itself.

### Lack of Leadership

Globalization will continue rapidly, but the U.S led world order is getting diminished. An inconsistent, war-ridden United States lacks the will and ability to provide global leadership. Moreover, no other country is interested in taking its place. The West is having its own problems, and allies are only interested in hedging their bets. Therefore, there is no clear and definite way for globalization to progress and it is getting distorted.

### Power Distribution

China, Russia, Turkey, India, and some other emerging nations are getting powerful enough to dismantle the US led theory of globalization. But they lack synchronization and influence. Their values and interests are not compatible. So, a regionalized world is emerging. Americanization and globalization are neither believed to be one and the same now nor is it preached by these power-seeking nations.

### Weaker Underdogs

The regional economic powerhouses are getting more room to operate in today’s world. Russia is intruding in its backyard, Germany is experiencing firm control over Euro zone, and China is rapidly rising in the Asia-Pacific. These major countries are trying to consolidate power without caring for the smaller countries near them. It is a kind of ‘hollowing of the peripherals’ that is accelerating.

### Price Fluctuations of Natural Resources

The oil monopoly is deteriorating and many clashes and terrorist incidents are tearing the world apart. In such turmoil, the very essence of globalization is somehow getting blurred. These time-sensitive challenges are being faced by all international and huge global companies. While the problems don’t seem to end soon, the global companies now have the choice to exercise their power in a global scale. They may or may not adapt to the new trend, but their superiority and powers have definitely got a boost due to the predominantly geopolitical crises.

# Modern Theories

There are many theories and concepts associated with international trade. When companies want to go international, these theories and concepts can guide them to be careful and prepared.

There are four major modern theories of international trade. To have a brief idea, please read on.

## The Heckscher and Ohlin Model

The Heckscher–Ohlin theory deals with two countries’ trade goods and services with each other, in reference with their difference of resources. This model tells us that the comparative advantage is actually influenced by relative abundance of production factors. That is, the comparative advantage is dependent on the interaction between the resources the countries have.

Moreover, this model also shows that comparative advantage also depends on production technology (that influences relative intensity). Production technology is the process by which various production factors are being utilized during the production cycle.

The Heckscher–Ohlin theory tells that trade offers the opportunity to each country to specialize. A country will export the product which is most suitable to produce in exchange for other products that are less suitable to produce. Trade benefits both the countries involved in the exchange.

The differences and fluctuations in relative prices of products have a strong effect on the relative income gained from the different resources. International trade also affects the distribution of incomes.

## The Samuelson and Jones Model

According to Samuelson–Jones Model, the two major reasons for which trade influences the income distribution are as follows −

* Resources are non-transferable immediately and without incurring costs from one industry to another.
* Industries use different factors. The change in the production portfolio of a country will reduce the demand for some of the production factors. For other factors, it will increase it.

There are three factors in this model − Labor (L), Capital (K), and Territory (T).

Food products are made by using territory (T) and labor (L), while manufactured goods use capital (K) and labor (L). It is easy to see that labor (L) is a mobile factor and it can be used in both sectors. Territory and capital are specific factors.

A country with abundant capital and a shortage of land will produce more manufactured goods than food products, whatever may the price be. A country with territory abundance will produce more foods.

Other elements being constant, an increase in capital will increase the marginal productivity from the manufactured sector. Similarly, a rise in territory will increase the production of food and reduce manufacturing.

During bilateral trade, the countries create an integrated economy where manufactured goods and food production is equal to the sum of the two countries’ productions. When a nation does not trade, the production of a product will equal its consumption.

Trade gains are bigger in the export sector and smaller in the competing import sector.

## The Krugman and Obsfeld Model

The Krugman–Obsfeld Model is the standard model of trade. It implies two possibilities −

* The presence of the relative global supply curve stemming from the possibilities of production.
* The relative global demand curve arising due to the different preferences for a selected product.

The exchange rate is obtained by the intersection between the two curves. An improved exchange rate – other elements being constant – implies a substantial rise in the welfare of that country.

## The Michael Porter Model

Michael Porter identified four stages of development in the evolution of a country. The dependent phases are − Factors, Investments, Innovation, and Prosperity.

Porter talked extensively on attributes related to **competitive advantages** which an organization can achieve relative to its rivals which consists of Lower Cost and Differentiation. These advantages derive from factor(s) that permit an organization to outperform its competition, such as superior market position, skills, or resources.

In Porter's view, the strategic management of businesses should be concerned with creating and continuing competitive advantages.

# Global Competitiveness

The International Institute for Management Development defines competitiveness as "a field of economic knowledge which analyzes the facts and policies that shaped the ability of a nation to create and maintain an environment that sustains more value creation for its enterprises and more prosperity for its people."

The World Economic Forum defines global competitiveness as "the ability of a country to achieve sustained high rates of growth in gross domestic product (GDP) per capita."

## Factors Affecting Global Competitiveness

Business firms abide by the rules and regulations formed by the government. The government assumes a very important role in enhancing competitiveness. Governments must promote trade by reengineering systems and procedures. Governments should be more responsive, reducing bureaucratic red tape.

* **Physical infrastructure** plays a critical role in improving the global competitiveness of a country. This will lead to the smoother movement of people, products, and services, facilitating faster delivery of goods and services.
* The business environment should be as such that it improves **coordination among public-sector agencies**. The best methods include providing support and incentives for R&D activities, HRD and education, encouraging innovativeness and creativity, facilitating the improvement of industrial blocks, and productivity enhancements of SMEs.
* **High total factor productivity** (TFP) is a boon for economic growth. It shows the synergy and efficiency of both capital and HR utilization and promotes national competitiveness.
* **Productivity campaigns** are important because they promote public-awareness and provide mechanisms to use the productivity tools and techniques.
* **Intensifying R&D activities** that contribute to creativity, innovation, and indigenous technological development is also an important factor.
* **Improving the capacities of SMEs** to become increasingly productive suppliers and exporters makes strategic sense.

**GLOBAL COMPETITIVENESS INDEX**

The Global Competitiveness Reports asses the competitiveness landscape of 144 economies of the world. It provides information about the drivers of their productivity and prosperity. The Report is the most comprehensive assessment of national competitiveness worldwide.