Auditing Course Material

Part 41 of 61 (Chapters 4001-4100)

3. Benefits of International Business

The benefits of international business to the firms are listed below:

(i) Prospects for higher profits: International business can be more profitable than the domestic business. When the domestic prices are lower, business firms can earn more profits by selling their products in countries where prices are high.

(ii) Increased capacity utilisation: Many firms setup production capacities for their products which are in excess of demand in the domestic market. By planning overseas expansion and procuring orders from foreign customers, they can think of making use of their surplus production capacities and also improving the profitability of their operations. Production on a larger scale often leads to economies of scale, which in turn lowers production cost and improves per unit profit margin.

(iii) Prospects for growth: Business firms find it quite frustrating when demand for their products starts getting saturated in the domestic market. Such firms can considerably improve prospects of their growth by plunging into overseas markets.

(iv) Way out to intense competition in domestic market: When competition in the domestic market is very intense, internationalisation seems to be the only way to achieve significant growth.

(v) Improved business vision: The growth in international business of many companies is essentially a part of their business policies or strategic management.

(vi) Leverage valuable skills: The firm can earn a greater return by leveraging any valuable skills developed in foreign operations and transferring them to other entities within the firm's global network
of operations.

(vii) Risk reduction: Operating in countries with different business cycles can minimize swings in sales and profits. The key is the fact that sales decrease or grow more slowly in a country that's in a recession and increase or grow more rapidly in one that's expanding economically.

(viii) Location economics: The firm can realize location economies by dispersing individual value-creation activities to those locations around the globe where they can be performed most efficiently and effectively.

4. Globalization and its Drivers

Globalization is the process by which an activity or undertaking becomes worldwide in scope. It refers to the absence of borders and barriers to trade between nations. Globalization is defined as increased permeability of traditional boundaries of almost every kind, including physical borders such as time and space, nation states and economies, industries and organisations and less tangible borders such as cultural norms.

As a consequence of increased global operation, the global economy is becoming more integrated than ever before. This gradual integration leads to the emergence of global village.

The UNCTAD defines globalization at the macro level as follows: **The concept of globalization refers to both an increasing flow of goods and services and resources across national borders and to the emergence of complementary set of organisational structure to manage expanding network of international economic activity and transaction.**

Strictly speaking, a global economy is one where firms and financial institutions operate transnationally, i.e., beyond the confines of national boundaries. In such a world of goods, factors of production and financial assets would be almost perfectly substitutes everywhere and it would no longer be possible to consider nation states as distinct economic identities with autonomous decision making power in the pursuit of national objectives. The public goods that are needed to maintain an open market system, such as secure property rights and stable monetary system would become a global responsibility.

4. Globalization and its Drivers

Main reasons, that have caused Globalization, are:

1. Improved transport, making global travel easier: There has been a rapid growth in air-travel, sea-travel, enabling greater movement of people and goods across the globe.

2. Containerisation: Containerisation is a system of standardised transport, that uses a common size of steel container to transport goods. The widespread adoption of containers enabled an improvement in trade and contributed to the process of globalization.

3. Improved technology: Technological advancement has made it easier to communicate and share information around the world. Important advancement in technology and the world's telecommunications infrastructure has led to revolutionary changes in global communication. Some homes and many offices now have multiple links to the outside world, via telephones (land lines and mobiles), fax machines, digital and cable television, electronic mail and the internet.

4. Liberalisation of foreign trade and foreign investment policies: Governments can use trade barriers to increase or decrease (regulate) foreign trade and to decide what kinds of goods and how much of each, should come into the country. These days, the barriers on foreign trade and foreign investment are removed to a large extent. This meant that goods could be imported and exported easily, and also foreign companies could set up factories and offices here. Removing barriers or restrictions set by the government is what is known as liberalisation. Reduced tariff barriers encourage global trade, with continuous efforts by the World Trade Organization WTO.

5. Transnational corporations: Among the many economic factors driving globalisation, the role of transnational corporations (TNCs) is particularly important. TNCs are companies that produce goods or market services in more than one country.

6. Expansion of Cross-National Cooperation: Governments have come to realize that their own interests can be addressed through international cooperation by means of treaties, agreements, and consultation. The willingness to pursue such policies is due largely to these three needs:

- To gain reciprocal advantages
- To attack problems jointly that one country acting alone cannot solve
- To deal with areas of concern that lie outside the territory of any nation

7. Development of robust financial system: Companies and governments have developed a variety of financial services that facilitate global commerce. Today, because of bank credit agreements, clearing arrangements that convert one currency into another and insurance that covers such risks of nonpayment and damage en route, most producers can be paid relatively easily for goods and services sold abroad. Globally integrated financial markets undertake billions of dollars' worth transactions within seconds in the electronic circuits.

8. Improved mobility of capital: In past few decades, there has been a general reduction in capital barriers, making it easier for capital to flow between different economies. This has increased the ability for firms to receive finance. It has also increased the global interconnectedness of global financial markets.

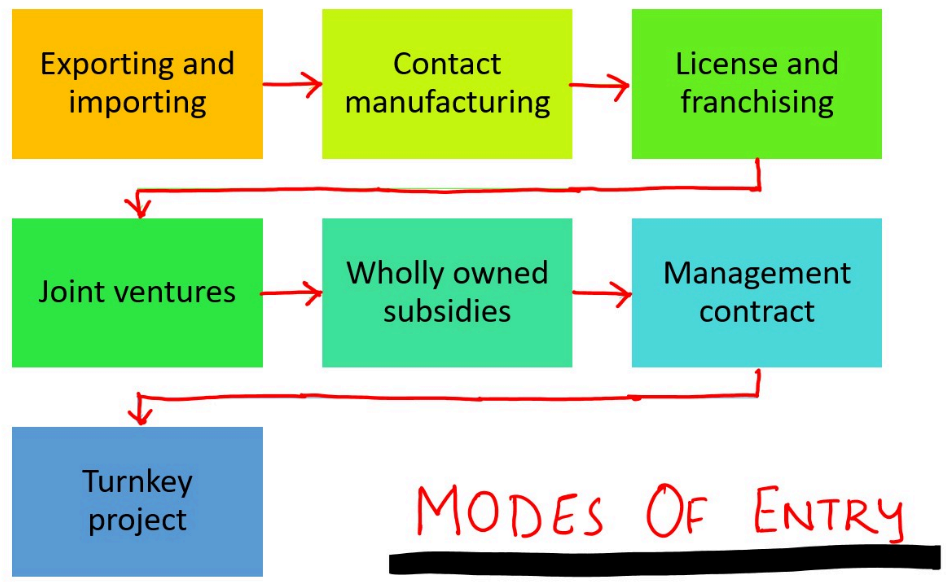
9. Increased mobility of labour: People are more willing to move between different countries in search for work. Global trade remittances now play a large role in transfers from developed countries to developing countries.

10. Weightless Economy or Knowledge Economy: In contrast to previous eras, the global economy is no longer primarily agricultural or industrial in its basis. The weightless economy is one in which products have their base information, as in the case with computer software, media and entertainment products and internet-based services. A knowledge economy is one in which much of the workforce is involved not in the physical production or distribution of material goods, but in their design, development, technology, marketing, sale and servicing. Both of them have contributed to globalization.

11. Growth in Consumer Pressures: Today more consumers know more about products and services available in other countries that they can afford to buy and want the access to greater variety in quality, price, and characteristics.

5. Modes of Entry

Modes of entry into International Business are given below. They are given in the order (sequence), in which any firm would like to enter into foreign market.



1. Exporting and Importing
2. Contract Manufacturing
3. Licensing and Franchising
4. Joint Ventures
5. Wholly Owned Subsidiaries
6. Management Contract
7. Turnkey Project

5. Modes of Entry

There are two important ways in which a firm can export or import products: direct and indirect exporting/importing.

In case of **direct exporting/importing**, a firm itself approaches the overseas buyers/ suppliers and looks after all the formalities related to exporting/ importing activities including those related to shipment and financing of goods and services. I**ndirect exporting/ importing**, on the other hand, is one where the firm's participation in the export/import operations is minimum, and most of the tasks relating to export/import of the goods are carried out by some middlemen such as export houses or buying offices of overseas customers located in the home country or wholesale importers in the case of import operations. Such firms do not directly deal with overseas customers in the case of exports and suppliers in the case of imports.

In considering exporting as its entry mode, a firm must consider many other factors besides which form of exporting to use, including

1. government policies,
2. marketing concerns,
3. logistical considerations, and
4. distribution issues.

Major **advantages** of exporting/importing include:

- As compared to other modes of entry, exporting/importing is the easiest way of gaining entry into international markets.
- The business firms are not required to invest that much time and money as is needed when they desire to enter into joint ventures or set up manufacturing plants and facilities in host countries.
- Exposure to foreign investment risks is nil or much lower.

Major **limitations** of exporting/importing are as follows:

- The exporting/importing involves additional packaging, transportation, insurance, custom duty and a variety of other levies and charges, which substantially increase product costs and make them less competitive.
- The export firms in general do not have much contact with the foreign markets. This puts the export firms in a disadvantageous position vis-à-vis the local firms which are very near the customers and are able to better understand and serve them.

5. Modes of Entry

Contract manufacturing refers to a type of international business where a firm enters into a contract with one or a few local manufacturers in foreign countries to get certain components or goods produced as per its specifications. Contract manufacturing is also known as Outsourcing. All the major international companies such as Nike, Reebok, Levi's and Wrangler today get their products or components produced in the developing countries under contract manufacturing.

Contract manufacturing offers several **advantages**:

- It permits the international firms to get the goods produced on a large scale without requiring investment in setting up production facilities.
- Contract manufacturing saves cost if the local producers happen to be situated in countries which have lower material and labour costs.

The major **disadvantages** of contract manufacturing are:

- Local firms might not adhere to production design and quality standards, thus causing serious product quality problems to the international firm.
- Local manufacturer in the foreign country loses his control over the manufacturing process because goods are produced strictly as per the terms and specifications of the contract.
- The local firm producing under contract manufacturing is not free to sell the contracted output as per its will. It has to sell the goods to the international company at predetermined prices.
- Sometimes, there are ethical issues like employment of child labour or poor labour welfare by local manufacturer to save the cost.

5. Modes of Entry

Licensing is a contractual arrangement in which one firm grants access to its patents, trade secrets or technology to another firm in a foreign country for a fee called royalty. The firm that grants such permission to the other firm is known as licensor and the other firm in the foreign country that acquires such rights to use technology or patents is called the licensee. It may be mentioned here that it is not only technology that is licensed. In the fashion industry, a number of designers license the use of their names. In some cases, there is exchange of technology between the two firms. Sometimes there is mutual exchange of knowledge, technology and/or patents between the firms which is known as cross-licensing.

Firms are not advised to use licensing in countries that offer weak protection for intellectual property because they may have difficulty enforcing licensing agreements in the host country's courts. On the other hand, the use of licensing may be encouraged by high tariffs and non-tariff barriers, which discourage imports, or by host country restrictions on FDI or repatriation of profits.

Normally the terms of a licensing agreement are specified in a detailed legal contract, which addresses such issues as

- specifying the boundaries of the agreement,
- determining compensation,
- establishing rights, privileges, and constraints, and
- specifying the duration of the contract.

Franchising is a term very similar to licensing. One major distinction between the two is that while the former is used in connection with production and marketing of goods, franchising is used for service businesses. The other point of difference between the two is that franchising is relatively more stringent than licensing. Franchisers usually set strict rules and regulations as to how the franchisees should operate while running their business. Barring these two differences, franchising is pretty much the same as licensing. McDonald, Pizza Hut and Wal-Mart are examples of some of the leading franchisers operating worldwide.

A **franchising agreement** allows an independent entrepreneur or organization, called the franchisee, to operate a business under the name of another, called the franchisor, in return for a fee. The franchisor provides its franchisees with trademarks, operating systems, and well-known product reputations, as well as continuous support services such as advertising, training, reservation services (for hotel operations), and quality assurance programs.

Some of the specific **advantages** of licensing/franchising are as follows:

- Under the licensing/franchising system, it is the licensor/ franchiser who sets up the business unit and invests his/her own money in the business. As such, the licensor/franchiser has to virtually make no investments abroad. Licensing/franchising is, therefore, considered a less expensive mode of entering into international business.
- Since no or very little foreign investment is involved, licensor/ franchiser is not a party to the losses, if any, that occur to foreign business. Licensor/franchiser is paid by the licensee/franchisee by way of fees fixed in advance as a percentage of production or sales turnover. This royalty or fee keeps accruing to the licensor/franchiser so long as the production and sales keeps on taking place in the licensee's/franchisee's business unit.
- Since the business in the foreign country is managed by the licensee/franchisee who is a local person, there are lower risks of business takeovers or government interventions.
- Licensee/franchisee being a local person has greater market knowledge and contacts which can prove quite helpful to the licensor/franchiser in successfully conducting its marketing operations.

Licensing/franchising suffers from the following **weaknesses**:

- When a licensee/franchisee becomes skilled in the manufacture and marketing of the licensed/franchised products, there is a danger that the licensee can start marketing an identical product under a slightly different brand name. This can cause severe competition to the licensor/ franchiser.
- If not maintained properly, trade secrets can get divulged to others in the foreign markets. Such lapses on the part of the licensee/ franchisee can cause severe losses to the licensor/franchiser.
- Over time, conflicts often develop between the licensor/franchiser and licensee/franchisee over issues such as maintenance of accounts, payment of royalty and non-adherence to norms relating to production of quality products.

Usually, the companies start with Licensing first and then move to Franchising.

5. Modes of Entry

Joint venture is a very common strategy for entering into foreign markets. It is also called Partnering. A joint venture means establishing a firm that is jointly owned by two or more otherwise independent firms. In the widest sense of the term, it can also be described as any form of association which implies collaboration for more than a transitory period. A joint ownership venture may be brought about in three major ways:

1. Foreign investor buying an interest in a local company
2. Local firm acquiring an interest in an existing foreign firm
3. Both the foreign and local entrepreneurs jointly forming a new enterprise.

Major **advantages** of joint venture include:

- Since the local partner also contributes to the equity capital of such a venture, the international firm finds it financially less burdensome to expand globally.
- Joint ventures make it possible to execute large projects requiring huge capital outlays and manpower.
- The foreign business firm benefits from a local partner's knowledge of the host countries regarding the competitive conditions, culture, language, political systems and business systems.
- In many cases entering into a foreign market is very costly and risky. This can be avoided by sharing costs and/or risks with a local partner under joint venture agreements.

Major **limitations** of a joint venture are discussed below:

- Foreign firms entering into joint ventures share the technology and trade secrets with local firms in foreign countries, thus always running the risks of technology and secrets being disclosed to others.
- The dual ownership arrangement may lead to conflicts, resulting in battle for control between the investing firms.

5. Modes of Entry

This entry mode of international business is preferred by companies which want to exercise full control over their overseas operations. The parent company acquires full control over the foreign company by making 100 per cent investment in its equity capital. A wholly owned subsidiary in a foreign market can be established in either of the two ways:

1. Setting up a new firm altogether to start operations in a foreign country also referred to as a **green field venture**, or
2. Acquiring an established firm in the foreign country and using that firm to manufacture and/or promote its products in the host nation, referred as **brownfield venture**.

Major **advantages** of a wholly owned subsidiary in a foreign country are as follows:

- The parent firm is able to exercise full control over its operations in foreign countries.
- Since the parent company on its own looks after the entire operations of foreign subsidiary, it is not required to disclose its technology or trade secrets to others.

The **limitations** of setting up a wholly owned subsidiary abroad include:

- This form of international business is not suitable for small and medium size firms which do not have enough funds with them to invest abroad.
- Since the parent company owns 100 per cent equity in the foreign company, it alone has to bear the entire losses resulting from failure of its foreign operations.
- Some countries are averse to setting up of 100 per cent wholly owned subsidiaries by foreigners in their countries. This form of international business operations, therefore, becomes subject to higher political risks.

5. Modes of Entry

A management contract is an agreement whereby one firm provides managerial assistance, technical expertise, or specialized services to a second firm for some agreed-on time in return for monetary compensation. For its services the first firm may receive either a flat fee or a percentage of sales. The management contract may also specify performance bonuses based on profitability, sales growth, or quality measures. Management contracts allow firms to earn additional revenues without incurring any investment risks or obligations.

Major **advantages** of a management contract are as follows:

- Focus firm's resources on its area of expertise
- Minimal financial exposure

The **limitations** of Management contract include:

- Potential returns limited by contract
- May unintentionally transfer proprietary knowledge and techniques to contractee

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5. Modes of Entry

Another specialized strategy for participating in international business is the turnkey project. A turnkey project is a contract under which a firm agrees to fully design, construct, and equip a facility and then turn the project over to the purchaser when it is ready for operation. The turnkey contract may be for a fixed price so, the firm makes its profit by keeping its costs below the fixed price. Or the contract may provide for payment on a cost-plus basis, which shifts the risk of cost overruns from the contractor to the purchaser.

An increasingly popular variant of the turnkey project is the so-called **B-O-T project**, in which the firm builds a facility, operates it, and later transfers ownership of the project to some other party. Through this approach, the contractor profits from operation and ownership of the project for some period of time but bears any financial risks associated with it during this period.

Major **advantages** of a turnkey project are as follows:

- Focus firm's resources on its area of expertise
- Avoid all long-term operational risks

The **limitations** of turnkey project include:

- Financial risks (cost overruns, etc.)
- Construction risks (delays, problems with suppliers, etc.)

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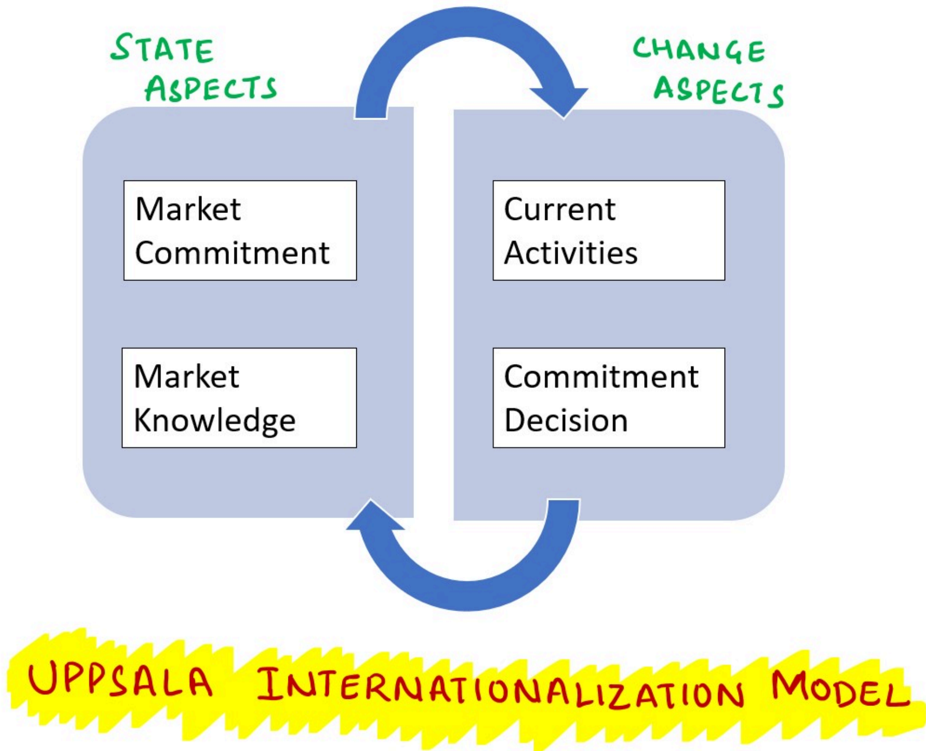
6. Uppsala Internationalization Model

Swedish researchers Johanson, Wiedersheim-Paul and Vahlne, from Uppsala University, proposed Uppsala Model. They believed most existing theories at that time toned down the problems of cultural differences and ignored the internal foundations needed so that companies could handle international activities. As a result, they developed their own model as a more independent model to explain the sequential steps in the direction of increased foreign dedication. The model was based on empirical observation from 4 Swedish manufacturers.



The Uppsala Internationalization Model distinguishes 4 different steps of entering an international market, which cannot be viewed independently of a company's situation, market and the market knowledge:

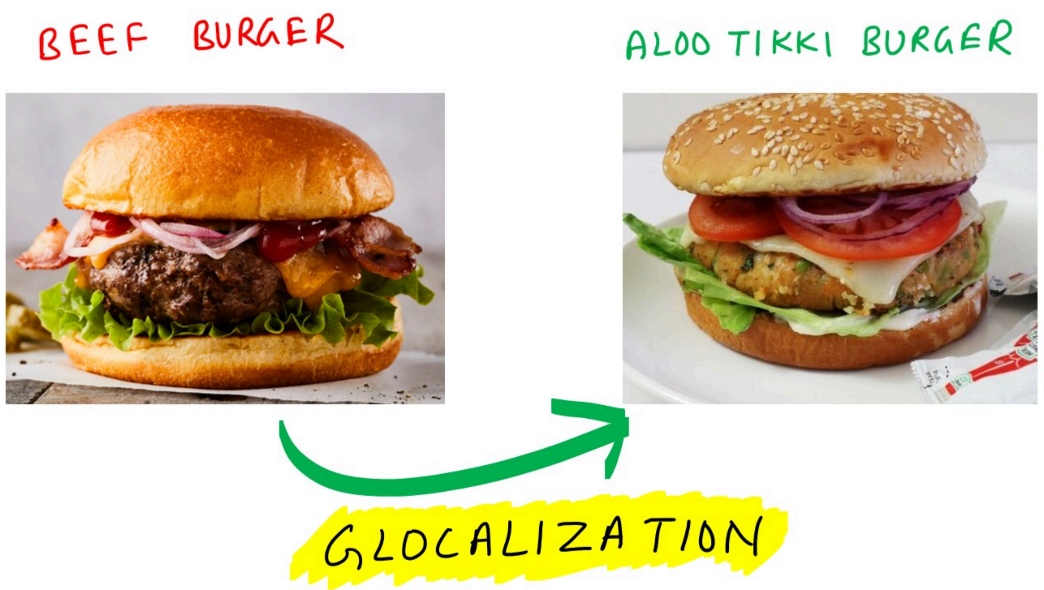
- Step 1: No regular export activities (sporadic export).
- Step 2: Export via independent representative (export mode).
- Step 3: Establishment of a foreign sales subsidiary.
- Step 4: Foreign production/manufacturing.

From the observation, they found out that companies normally start their expansion in a psychic nearby market. Physic distance is defined in terms of factors such as differences in language, culture, political systems, etc., which disturb the flow of information between the firm and the market. There, they have enhanced knowledge of the market and more control of resources, thereafter gradually when the companies have become more experienced and acquired better resources, they expand to the more distance market. (By distance market, they refer both to the cultural distance; as well the differences in language, politics, geographical and the difficulty to acquire knowledge and information from the market). Secondly, most often companies entered a new market through export before establishment of foreign sales subsidiary or foreign production.

The Uppsala model is based on 4 core concepts: market commitment, market knowledge, current activities and commitment decisions. These 4 concepts are then divided into state aspects and change aspects.

The 2 state aspects are market commitment, which is the resources committed to foreign markets, and market knowledge, which is the knowledge about foreign markets and operations possessed by the firm at a given time. The 2 change aspects are current activities and commitment decisions. The latter are the decisions to commit resources to foreign operations. The 4 core concepts are linked together and affect each other, as well as dependent on each other's existence. Market knowledge and market commitment are assumed to affect decisions regarding commitment of resources to foreign markets and the way current activities are performed. Market knowledge and market commitment are, in turn, affected by current activities and commitment decision. Thus, the process is seen as causal cycles.

7. Glocalization



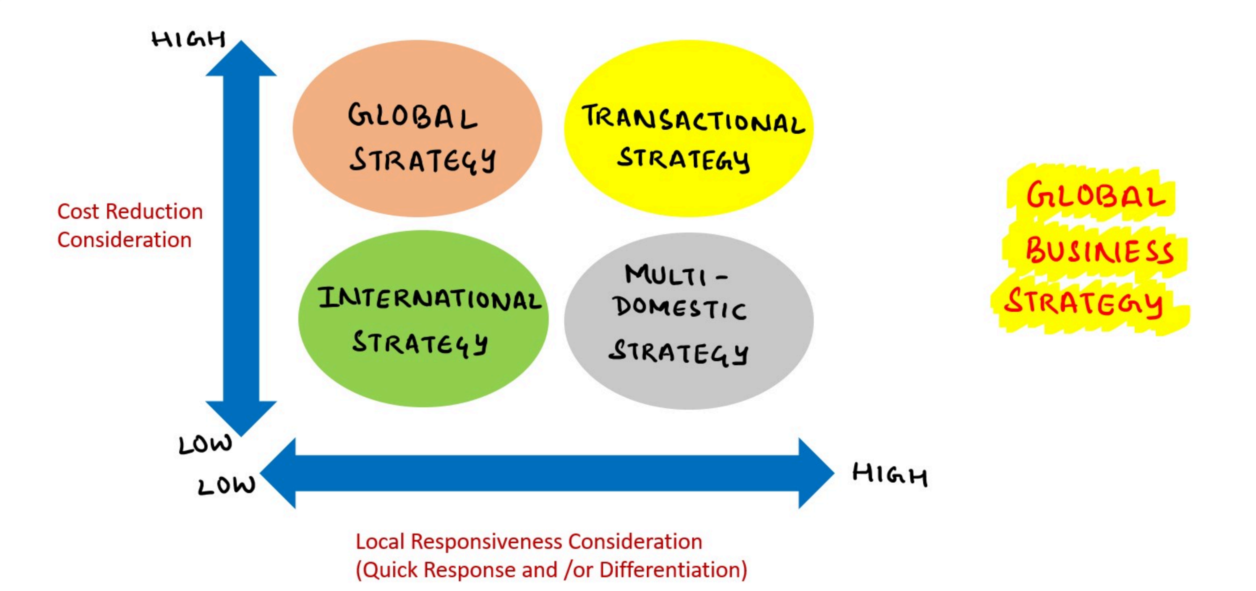
Glocalization is a combination of the words "globalization" and "localization", used to describe a product or service that is developed and distributed globally, but is also adjusted to accommodate the user or consumer in a local market. In other words, a company 'thinks globally but acts locally'. A common example would be cars that are sold worldwide but adjusted to meet local criteria such as emissions standards or what side the steering wheel is located. It could also focus on more cultural aspects, such as a global fast-food chain offering geographically specific menu items that cater to local tastes.

8. Global Business Strategy

A **Multinational Enterprise (MNE)** usually refers to any company with foreign direct investments. However, some writers reason that a company must have direct investments in some minimum number of countries to be an MNE. The term multinational corporation or multinational company (MNC) is often used as a synonym for MNE. It takes a global approach to foreign markets and production. It is willing to consider market and production locations anywhere in the world.

There are two main considerations when going international, **global integration (standardization for the purpose of cost reduction)** and **local responsiveness** as shown in the figure (called Integration-Responsiveness Grid, IR Grid).

Based on these 2 considerations, there are 4 strategies.
1. International Strategy
2. Multi-domestic Strategy
3. Global Strategy
4. Transactional Strategy



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8. Global Business Strategy

Companies implement an international strategy when they leverage core competencies around the globe in an industry marked by low pressure for global integration and local responsiveness (the lower left quadrant of the IR Grid). This approach emphasizes replicating home-country-based competencies, such as production expertise, design skills, or brand power, in foreign markets. The primacy of replication requires that foreign units operate activities that are configured and coordinated by the home-country headquarters. Ultimate control resides with executives there, given their reasoning that they best understand the application, protection, and extension of the company's core competencies. The testing ground of new idea is the home market, not foreign countries; hence, subsidiaries have limited autonomy to adapt products or processes. MNCs implementing an international strategy include Apple, Airbus, and Google.

This strategy is also often referred to as an exporting strategy. Products are produced in the company's home country and sent to customers all over the world. Subsidiaries, if any, functioning in this case are more likely to have local channels through which the products are being sold to the end-consumer.

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8. Global Business Strategy

Some MNCs face high pressure for local responsiveness and a low need to reduce costs via global integration (the lower right quadrant of the IR Grid). In these industries, unique local cultural, legal-political, and economic conditions spur the MNCs to adapt value activities. This approach represents the multidomestic strategy. Value-chain design follows the lead of foreign operations, not the home office’s direction. That is, the company’s subsidiaries in their respective local markets design, make, and market products that respond to local preferences. For example, a backpack factory in Singapore decides the size, shape, and style of product to make given their understanding that local customers see greater appeal in their preferred design even if their choices differ from those made by fellow operations in Turkey, Kenya, and Colombia.

The organization decentralizes operational decisions and activities to each country in which it is operating and customizes its products and services to each market. For example, McDonald food chain introduced “aloo tikki” burger in India for localization needs. For years, U.S. auto manufacturers maintained decentralized overseas units that produced cars adapted to different countries and regions. General Motors produced Opel in Germany and Vauxhall in Great Britain while Chrysler produced the Simca in France and Ford offered a Canadian Ford.

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8. Global Business Strategy

The global strategy drives worldwide performance by making and selling common products that vary little from country to country. Effectively, managers face high pressures for global integration yet low pressures for local responsiveness. Industries of this sort are found in the upper left quadrant of the IR Grid. MNCs in this situation implement absolute production and marketing standards to achieve the maximum efficiency gains of global integration.

The global strategy pushes companies to create products for a world market, manufacturing them on a global scale in a few highly efficient plants, and marketing them through a few focused distribution channels. It requires that MNCs aggressively exploit location economies to maximize the scale effects of making a standardized product for a global market segment; using resources for anything other than improving efficiency erodes competitiveness. Likewise, the strategy calls for selling globally standardized products that require little to no local adaptation. Hence, the global strategy sees the world as a single market.

The organization offers standardized products and uses integrated operations. For example, the same Tata Nano was exported in all countries, that was being made in India.

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8. Global Business Strategy

Today’s environment of interconnected consumers, industries, and markets requires that an MNC, of the sort we see in the upper right quadrant of the IR Grid, configure a different type of value chain. It must exploit location economies while also applying coordination methods that leverage core competencies and, throughout it all, reconcile a complex mix of global and local pressures. Managing this feat enables the MNC to implement a transnational strategy, thereby differentiating capabilities and contributions from country to country, finding ways to learn systematically from its various environments, and diffusing this knowledge throughout its global operations.

The transnational strategy requires a sophisticated value chain that simultaneously implements integration, responsiveness, and learning. It configures its value activities, subject to satisfying minimum efficiency standards, from country to country given prevailing cultural, political, legal, and economic conditions. But, in a critical break from the multidomestic strategy, the transnational strategy champions the cause of interactive “global learning.”

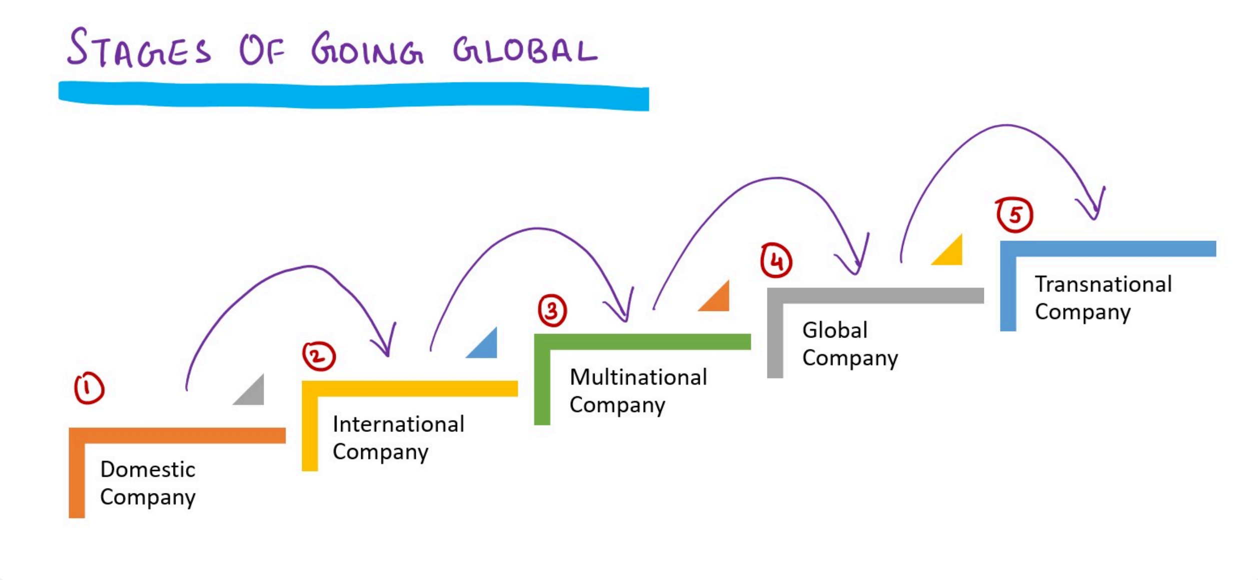
Rather than top-down (headquarters to a foreign subsidiary) or bottom-up (foreign subsidiary to the headquarters) coordination, the transnational strategy promotes knowledge flows from idea generators to idea adopters, no matter where one or the other resides. Headquarters only applies systems to motivate communication and collaboration.

8. Global Business Strategy

	International Strategy	Multi-Domestic Strategy	Global Strategy	Transnational Strategy
Orientation	Leverage core competencies and home country innovations into competitive positions abroad.	Differentiate products to respond to national differences in customer preferences, industry characteristics, or government regulation.	Target universal needs or wants that support selling standardized products worldwide. Emphasize volume, cost minimization, and efficiency.	Simultaneously manage the tensions of global integration and local differentiation in ways that leverage specialized knowledge and promote worldwide learning.
Value Chain Configuration	Concentrated: value configuration activities are set and directed by the home office.	Dispersed: Subsidiaries command discretion to adapt value activities to local conditions.	Concentrated: value chain configuration exploits location economics.	Concentrated to tap location economies. Dispersed. Subject to minimum efficiency standards to meet local preferences.
Value Chain Coordination	Centralized coordination: Coordination processes as the parent retains control of value activities to apply, regulate, and protect core competencies.	Subsidiaries operate quasi-independently. Autonomy lets them adapt activity to local marketplace circumstances.	Industry pressures to maximize standardization and contain costs require coordinating value activities operations from a global perspective.	Simultaneous goal of integration and responsiveness calls for sharing coordination between headquarters or subsidiaries.
Key Advantage	Facilitates the transfer of skills and expertise from the parent company to international units.	Reduced need for central support to manage local activities. Greater sensitivity to local preferences.	Make low-cost, high-quality products that differ little but appeal to consumers worldwide.	Supports efficiency, compels effectiveness, and leverages learning that drives innovations through units worldwide.
Key Disadvantage	Centralizing the value chain in the home country often weakens configuration efficiency and coordination flexibility.	Encourages “mini-me” phenomenon that replicates value activities across subsidiaries.	Reduced learning opportunities given the dominance of global standards. Requires rigorous coordination to regulate a global matrix of inputs and outputs.	Requires elaborate mechanisms to integrate dispersed operations. Difficult to configure, tough to coordinate and prone to performance shortfalls.

9. Stages of Going Global

Having chosen a strategy, now let us discuss the stages, through which the company will move from being a “Domestic” company to “transnational” company.



Following are the stages of Going Global:

1. Domestic Company
2. International Company
3. Multinational Company
4. Global Company
5. Transnational Company

9. Stages of Going Global

Market potential is limited to the home country. Production and marketing facilities are located at home only. Surplus may or may not be exported. There are no overt efforts to develop foreign markets. It may add new product lines, serve new local markets but whole planning is limited to national markets only.

Features:

- Their focus remains with domestic market.
- Their productions facilities remain based in-home country. Their analysis is focused on the national market.
- They do not think globally and avoid taking risk in going global.
- Their top management may have traditional kind of business management competency and less global expertise.
- They perceive that there is risk in expanding into global market and thus they try to play safe and satisfied with whatever gains they are getting in domestic market.

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9. Stages of Going Global

Some ambitious efficient domestic companies after going beyond their domestic marketing capacities start thinking of expanding their operations in International Markets. The main strategies for entering international market are:

- Off-shoring/global outsourcing (seeking cheaper source of raw material or labour)
- Exporting
- Licensing
- Franchising
- Joint Ventures/Acquisitions
- Direct Investments

Even though they think of international markets, still they are ethnocentric or domestic oriented. These companies adopt the strategy of locating the branches of their companies in other countries and practice the same domestic operations in foreign markets, including the same promotion, price, product etc. policies. The features of such companies are:

- Focus on going beyond domestic
- Their management remains ethnocentric with a vision to expand internationally. They extend their domestic products, domestic prices and other business practices to foreign countries.
- They keep their marketing mix constant and extend their operations to new countries.
- Their management style remains centralized for their home nation and extended top down to the overseas market country.

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9. Stages of Going Global

If after some time, international companies realizes that the domestic model and practices adopted through extension policies do not serve the purpose. The foreign customers may not prefer the products that are sold in domestic market. Hence, these companies respond to the needs of different customers in different countries and produce such goods and services that will satisfy them. The features of such companies are:

- Companies when they spread their wings to more nations become multinational companies.
- Sooner or later, they realize that they have to change their marketing mix according to the foreign market.
- This can also be termed as multi domestic, in which different strategies are adopted for different market.
- The management of such companies remains decentralized and even production may be in the host country.
- Performance evaluation is done at different host countries.

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9. Stages of Going Global

The global company adopts global strategy for marketing its products. It may produce either in the home country or in any other single country and can market its products throughout the world. It may also produce the products globally and market them domestically. The features of such companies are:

- Such companies have a global marketing strategy.
- They either produce in home country or in a single country and focus marketing globally.
- They adapt to the market conditions according to the foreign market.
- Their performance evaluation is done worldwide.

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9. Stages of Going Global

Transnational Company operates at the global level by way of utilizing global resources to serve the global markets. It has geocentric orientation and has integrated network. Its key assets are dispersed, and every sub-unit of the company contributes towards achievement of the company's objectives. It produces best quality raw materials from the cheapest source in the world, process them in the country wherever it is economical and sells the finished products in those markets where prices are favourable. The features of such companies are:

- Transnational companies have a geocentric approach, which means they think globally and act locally.
- Transnational companies collect information worldwide and scan it for use beyond geographical boundaries.
- The vision of such companies is to grow more in a global way.
- The R&D, management, product development is shared worldwide.
- Their human resources procurement and development remains globally

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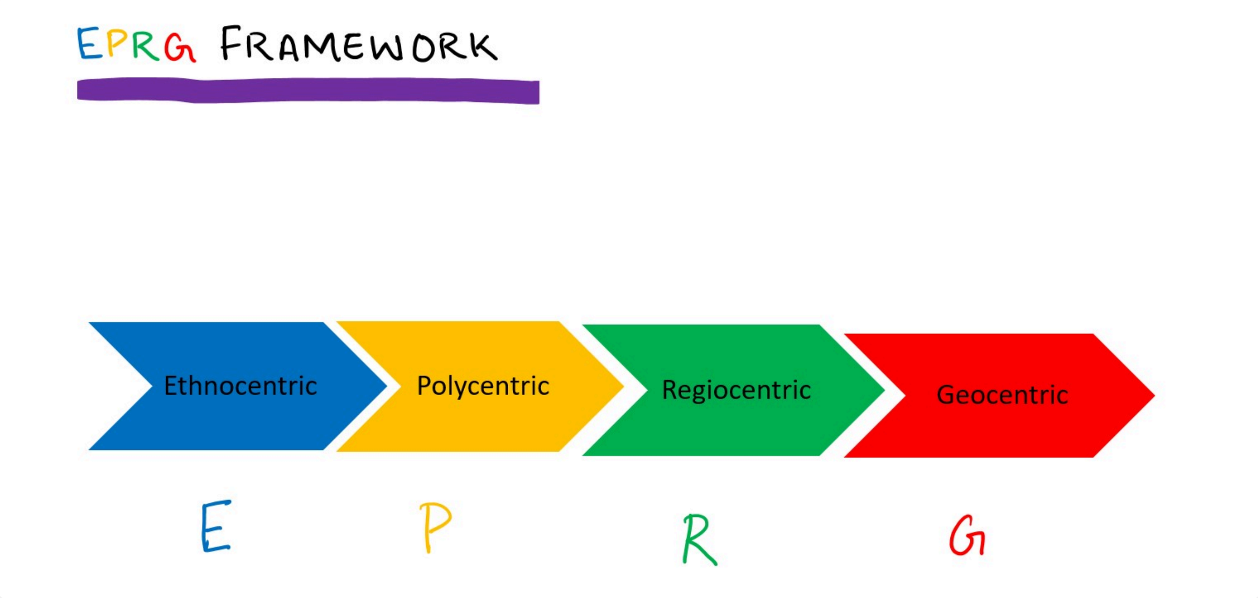
10. Orientation of Firms

EPRG framework

A firm having a presence in the global market has to decide the manner in which it will enter and operate there. Firms in the international market have a different orientation and operating strategy. The country in which a company has it's headquarter is **Home country** and countries where it has subsidiaries are known as **Host countries.**

The **EPRG Framework** helps the company to decide the way in which strategic decisions are being made and how the company manages operations between headquarter and its subsidiaries. The concept of EPRG was introduced by **Howard V. Perlmutter** within the journal article "**The Tortuous Evolution of Multinational Enterprises**" in 1969. EPRG stands for ethnocentric, polycentric, regio-centric, geocentric.

Please note the order of predisposition towards these approaches is starting from Ethnocentric, then Polycentric, then Regio-centric and finally Geocentric.



10. Orientation of Firms

The prevailing attitude of senior management in this orientation is that the way of doing business, at home, is applicable to the rest of the world. The attitude is probably that national employees and leaders are more capable to maintain international tasks than non-native employees recruited in the host-country. The practices and policies of headquarters are transferred to the international subsidiaries, which need to comply with these standards. The plans for overseas market are developed in the home office of the company. Personnel are hired from the home country. Also, the promotion and distribution strategies are similar to those employed in the home country.

10. Orientation of Firms

The assumption of managers in this orientation is that the '**one-size-fits-all**' approach is unfeasible. Subsidiaries are managed as autonomous units, who are allowed to manage their operations as they see fit. This leads to a broader organizational culture, where top positions are not as heavily staffed by nationals from headquarter, and potentially to a better understanding of local needs and demands.

10. Orientation of Firms

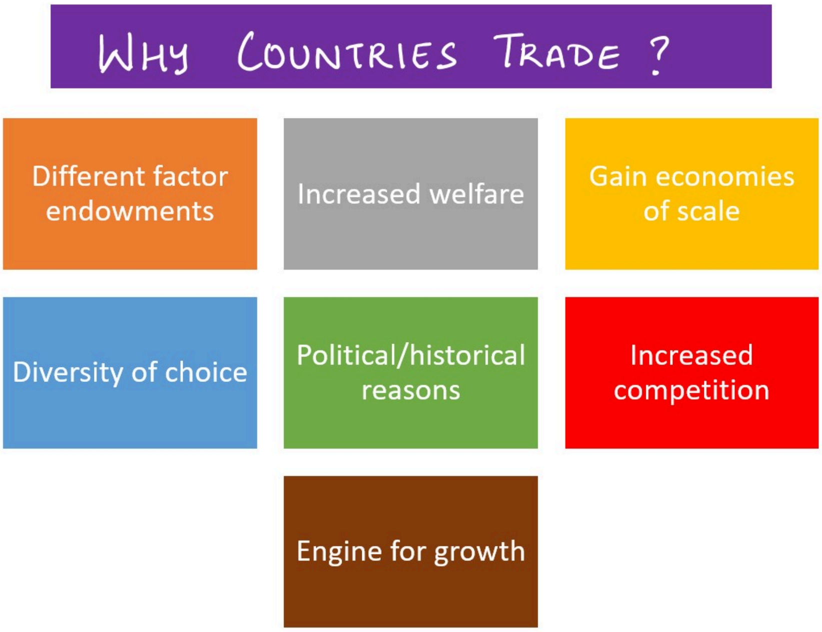
In this approach, a firm treats a group of countries with similar characteristics as a single market and accordingly designs a marketing strategy. Countries like India, Pakistan and Bangladesh possess similar characteristic and can be served well with a single marketing strategy.

10. Orientation of Firms

This approach maintains a balance between home and host market. This orientation does not regard nationality as a competitive advantage or disadvantage. The employees are recruited from all over the world, so that the best people are recruited to solve global problems. The MNC tries to develop both global differentiation and global integration between headquarter and foreign subsidiaries. The focus is therefore to gain the potential advantages of an integrated company, and to gain the advantages of differentiation in various aspects like, product offerings.

1. Introduction

Trade is the voluntary exchange of goods, services, assets, or money between one person or organization and another. Because it is voluntary, both parties to the transaction must believe they will gain from the exchange or else they would not complete it. **International trade** is trade between residents of two countries. The residents may be individuals, firms, not-for-profit organizations, or other forms of associations.



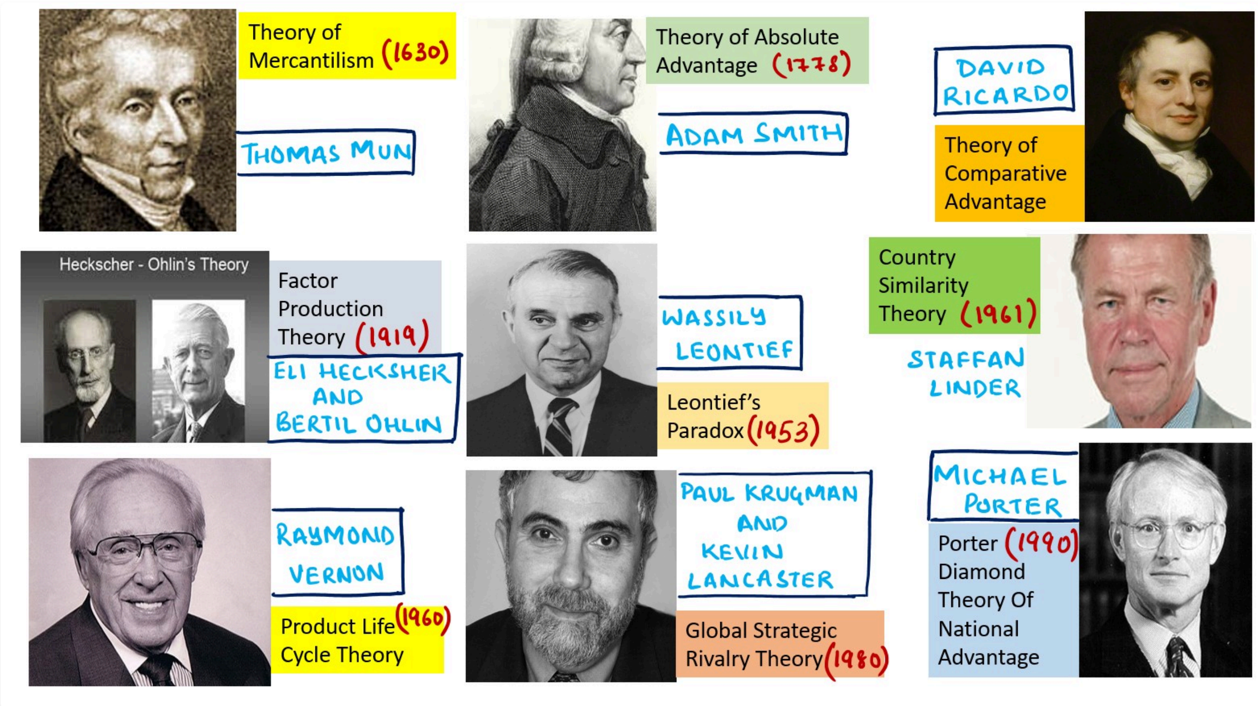
Some of the reasons, why countries trade with each other, are:

- **Different factor endowments** - Some economies are rich in natural resources while others have relatively little. Trade enables economies to specialize in the export of some resources and earn revenue to pay for imports of other goods.
- **Increased welfare** - Specialization and trade allow countries to gain a higher level of consumption than they would do domestically, and this leads to increased welfare and higher living standards.
- **To gain economies of scale** - With specialization and production on a larger scale than may be possible domestically, a country may be able to gain more economies of scale. This will lead to lower average costs and benefit consumers through lower prices.
- **Diversity of choice** - Trade enables us to access goods and services that we may not be able to produce ourselves.

- **Political / historical reasons** - Some trade takes place for political and other reasons relating to history and tradition, though this is generally diminishing in importance.
- **Increased competition** - Increased global competition may help to spur domestic productivity improvements and give domestic firms a better incentive to innovate and improve their products. This will benefit consumers.
- **Trade may be an 'engine for growth'** - Increased trade may help to spur greater domestic economic growth and drive further improvements in living standards.

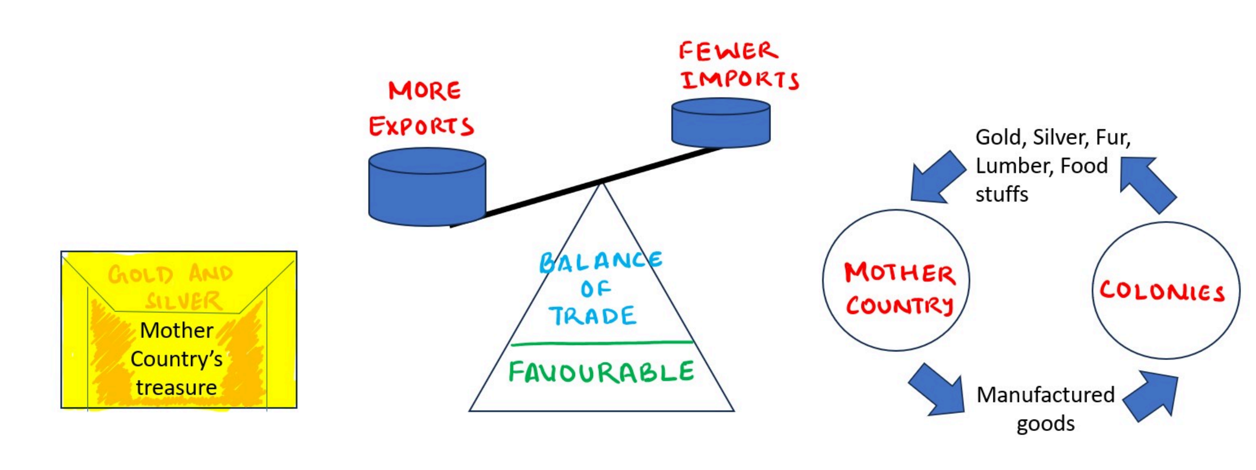
2. Theories of International Trade

International trade is incredibly significant for businesses, consumers, and workers. So, scholars have attempted to develop theories to explain and predict the forces that motivate such trade. Governments use these theories when they design policies, which they hope will benefit their countries' industries and citizens. Managers use them to identify promising markets and profitable internationalization strategies.



Let us study these theories one by one.

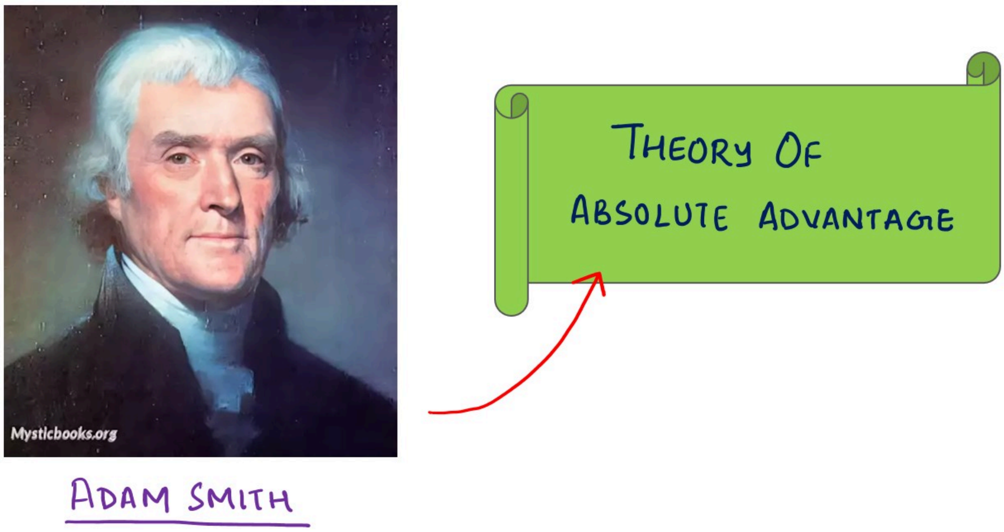
2. Theories of International Trade



Mercantilism is an economic philosophy that maintains that a country's wealth is measured by its holdings of gold and silver. So, if a country has gold mines and silver mines, it can get gold and silver but if a country has no mines, it can get gold and silver through trade. According to mercantilists, a country's goal should be to **get these holdings by promoting exports and discouraging imports.** The logic was that if foreigners will buy more goods from you than you buy from them, then the foreigners have to pay you the difference in gold and silver, enabling you to amass more treasure.

The fundamental aim of Mercantilism was to make a country strong. The strength of a country was tested with the help of the wealth of the country, above all, in that portion of wealth which consisted of precious metals like gold and silver. So, the Mercantilists attached greater importance to bullion (gold) because it was the most durable, useful and generally acceptable form of wealth.

2. Theories of International Trade



The main concept of absolute advantage is generally attributed to Adam Smith for his 1776 publication 'An Inquiry into the Nature and Causes of the Wealth of Nations' in which he countered mercantilist ideas. Smith argued that it was impossible for all nations to become rich simultaneously by following mercantilism because the export of one nation is another nation's import and instead stated that all nations would gain simultaneously if they practiced free trade and specialized in accordance with their absolute advantage. Smith also stated that the wealth of nations depends upon the goods and services available to their citizens, rather than their gold reserves. While there are possible gains from trade with absolute advantage, the gains may not be mutually beneficial. Comparative advantage focuses on the range of possible mutually beneficial exchanges.

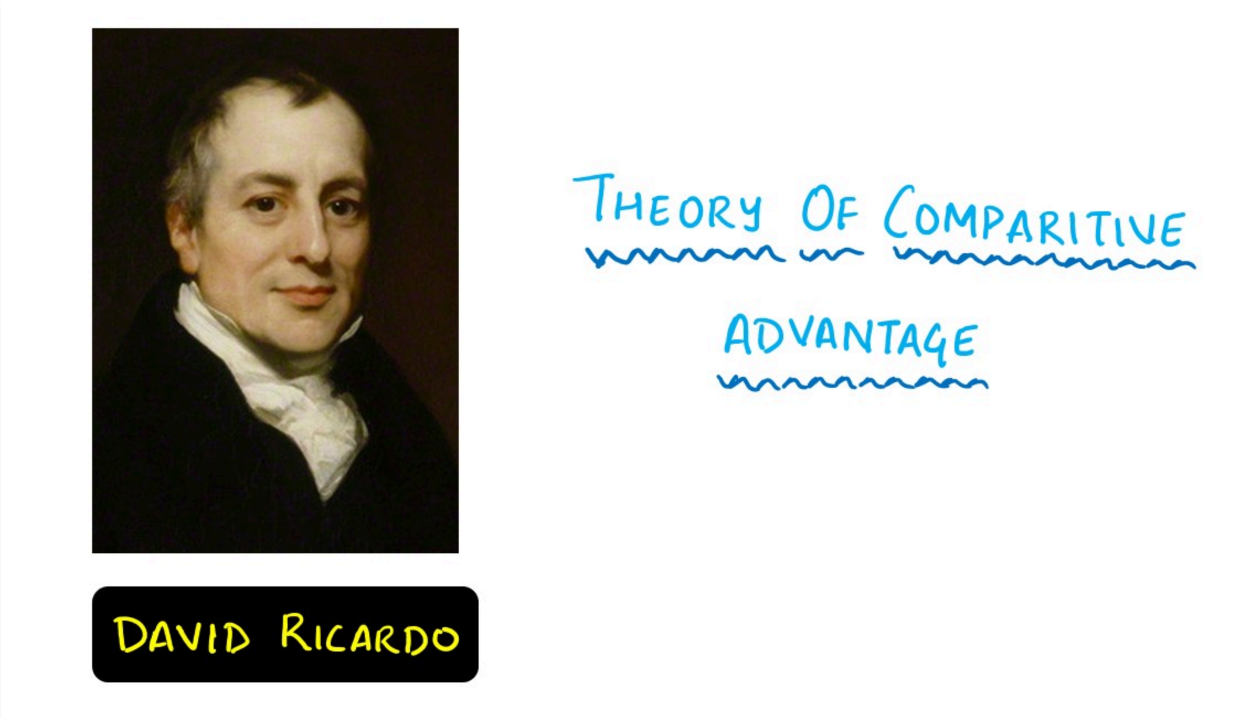
He stated that a country should export only those goods and services in which they are more productive than other countries are and import those goods and services for which other countries are more productive than them.

Suppose there are two countries A and B and they produce two commodities X and Y. The cost of producing these commodities is measured in terms of labour involved in their production. If each country has at its disposal 2 man-days and 1 man-day is devoted to the production of each of the two commodities, the respective production in two countries can be shown through the hypothetical Table below:

Absolute Cost Differences in Two Countries				
Country	Units of Labour (Man days)	Commodity X	Commodity Y	Ratio of Exchange
A	1	20	10	1 Unit of X = 0.5 Unit of Y
B	1	10	20	1 Unit of X = 2 Units of Y

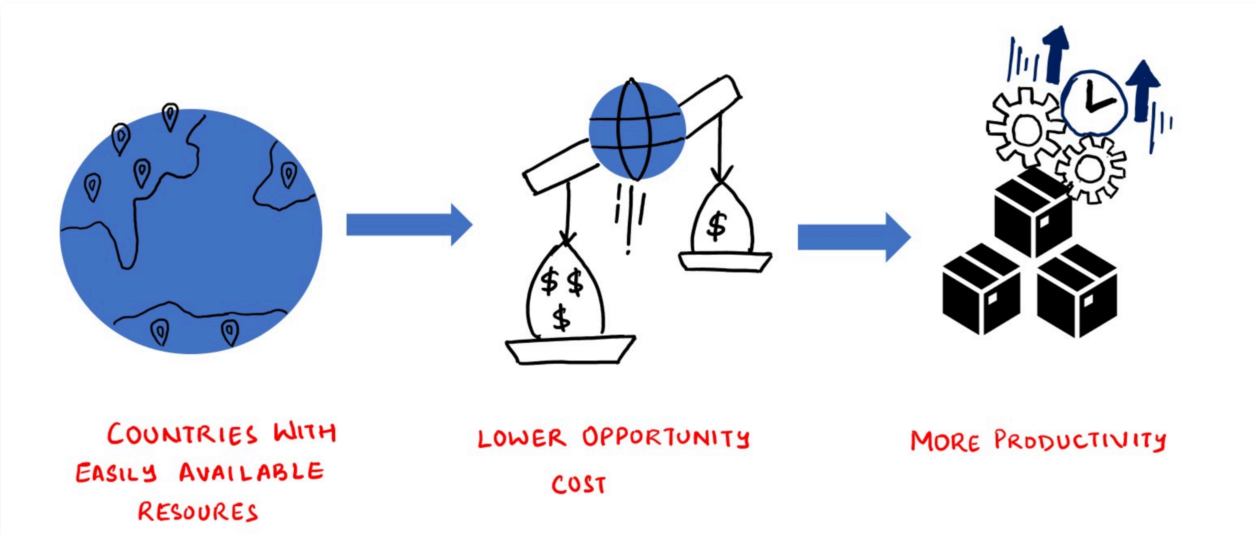
In country A, 1 man-day of labour can produce 20 units of X but 10 units of Y. In country B, on the other hand, 1 man-day of labour can produce 10 units of X but 20 units of Y. It signifies that country A has an absolute advantage in producing X while country B enjoys absolute advantage in producing commodity Y. Country A may be willing to give up 1 unit of X for having 0.5 unit of Y. At the same time, the country B may be willing to give up 2 units of Y to have I unit of X. If country A specializes in the production and export of commodity X and country B specializes in the production and export of commodity Y. Both the countries stand to gain.

2. Theories of International Trade



The challenge to the absolute advantage theory was that some countries may be better at producing both goods and, therefore, have an advantage in many areas. In contrast, another country may not have any useful absolute advantages.To answer this challenge, David Ricardo introduced the theory of comparative advantage in 1817. Ricardo reasoned that even if Country A had the absolute advantage in the production of both products, specialization and trade could still occur between two countries.

Comparative advantage occurs when a country cannot produce a product more efficiently than the other country; however, it can produce that product better and more efficiently than it does other goods. The difference between these two theories is subtle. Comparative advantage focuses on the relative productivity differences, whereas absolute advantage looks at the absolute productivity.



Thus, the Comparative advantage refers to the ability of a party to produce a particular good or service at a lower marginal and opportunity cost over another. Even if one country is more efficient in the production of all goods (absolute advantage in all goods) than the other, both countries will still gain by trading with each other, as long as they have different relative efficiencies.

For example, if, by using a machinery, a worker in one country can produce both shoes and shirts at 5 per hour, and a worker in a country with less machinery can produce either 2 shoes or 4 shirts in an hour, each country can gain from trade because their internal trade-offs between shoes and shirts are different. The less-efficient country has a comparative advantage in shirts, so it finds it more efficient to produce shirts and trade them to the more-efficient country for shoes. The net benefits to each country are called the gains from trade.

The idea of comparative advantage has been first mentioned in Adam Smith's Book - The Wealth of Nations: "**If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage.**" But the law of comparative advantages has been formulated by David Ricardo who investigated in detail advantages and alternative or relative opportunity in his 1817 book on the Principles of Political Economy and Taxation.

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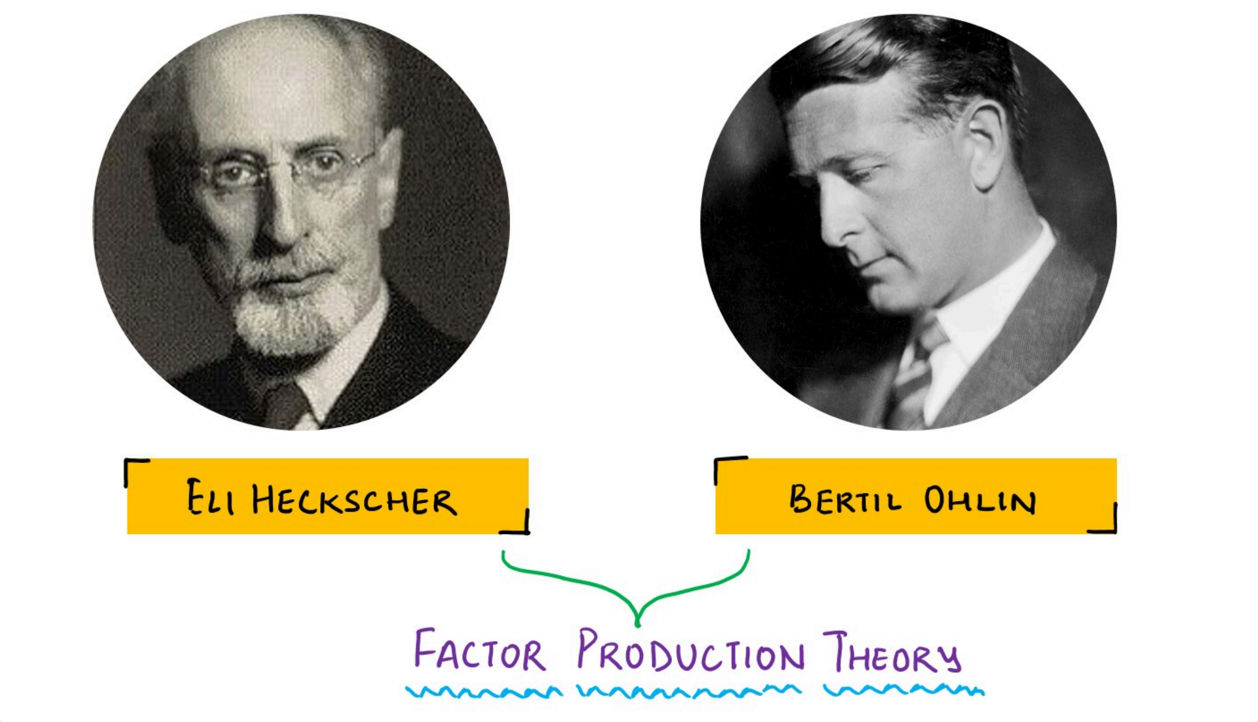
2. Theories of International Trade



Swedish economists, Eli Heckscher and Bertil Ohlin, at the Stockholm School of Economics developed the theory of relative factor endowments, now often referred to as the Heckscher-Ohlin (H-O) theory. These economists made two basic observations:

1. **Factor endowments** (or types of resources) vary among countries. For example, Argentina has much fertile land, Saudi Arabia has large crude oil reserves, and Bangladesh has a large pool of unskilled labor.
2. **Goods differ according to the types of factors** that are used to produce them. For example, wheat requires fertile land, oil production requires crude oil reserves, and apparel manufacturing requires unskilled labor.

From these observations, Heckscher and Ohlin developed their theory: A country will have a comparative advantage in producing products that intensively use resources (factors of production) it has in abundance. Thus, Argentina has a comparative advantage in wheat growing because of its abundance of fertile land; Saudi Arabia has a comparative advantage in oil production because of its abundance of crude oil reserves; and Bangladesh has a comparative advantage in apparel manufacture because of its abundance of unskilled labor.

The **Heckscher–Ohlin model** (H–O model) is a general equilibrium mathematical model of international trade. It was built upon David Ricardo's theory of comparative advantage by predicting patterns of commerce and production based on the factor endowments of a trading region. This theory explains that a country should produce and export that commodity which involves those factors of production that are abundantly available with the country.

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2. Theories of International Trade

The Heckscher-Ohlin theory suggests a country should export those goods that intensively use those factors of production that are relatively abundant in the country. The theory was tested empirically by economist Wassily Leontief using input-output analysis, a mathematical technique for measuring the interrelationships among the sectors of an economy. Leontief used his input-output model of the economy to estimate the quantities of labor and capital needed to produce 'bundles' of U.S. exports and imports. These results were not consistent with the predictions of the Heckscher-Ohlin theory. The results were that a country with a higher capital per worker has a lower capital/labor ratio in exports than in imports i.e., the imports of a capital-intensive country were more capital intensive than its exports. This econometric finding resulted in **Leontief's Paradox.**

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2. Theories of International Trade

Linder's country similarity theory suggests that most trade in manufactured goods should be between countries with similar per capita incomes and that intra-industry trade in manufactured goods should be common. Intra-industry trade is trade between two countries producing goods in same industry. For example, Japan exports Toyotas to Germany, and Germany exports BMWs to Japan. Linder hypothesized that international trade in manufactured goods results from similarities of preferences among consumers in countries that are at the same stage of economic development. In his view, firms initially manufacture goods to serve the firms' domestic market then they look for exporting opportunities to the foreign markets where consumer preferences resemble those of their own domestic market.

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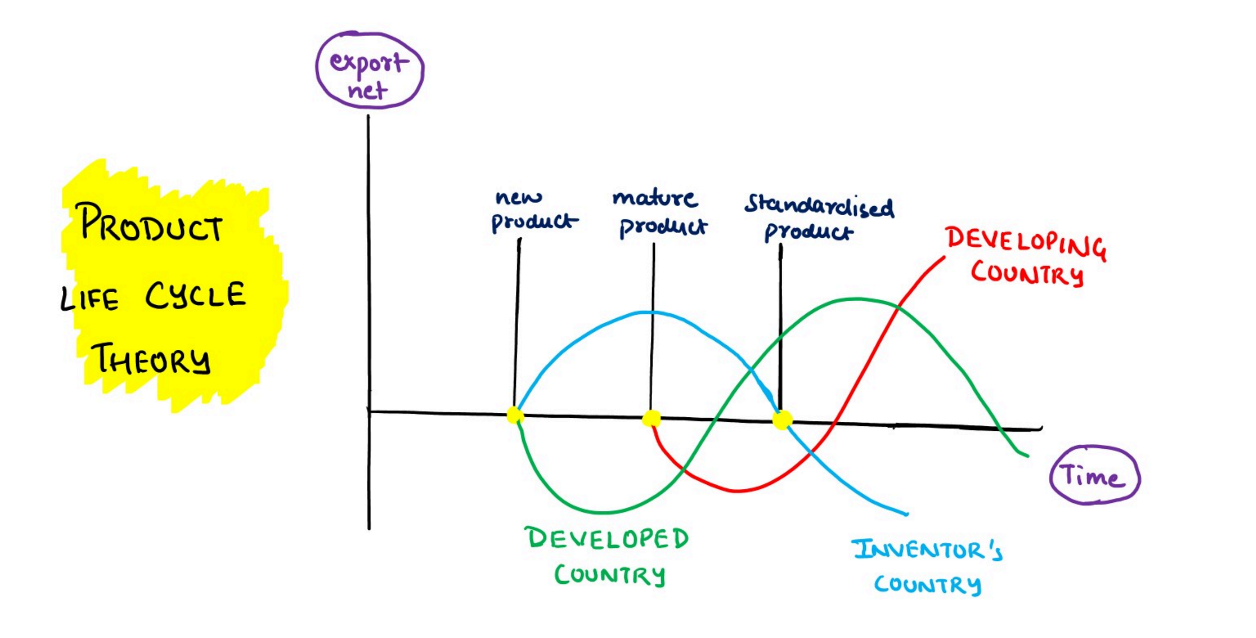
2. Theories of International Trade



Product life cycle theory, which originated in the marketing field to describe the evolution of marketing strategies as a product matures, was modified by Raymond Vernon of the Harvard Business School to create a firm-based theory of international trade. International product life cycle theory traces the roles of innovation, market expansion, comparative advantage, and strategic responses of global rivals in international production, trade, and investment decisions. According to Vernon's theory, the international product life cycle consists of three stages: new product, maturing product, and standardized product.

- In stage 1, the new product stage, a firm develops and introduces an innovative product. Because the product is new, the innovating firm is uncertain whether a profitable market for the product exists.
- In stage 2, the maturing product stage, demand for the product expands dramatically as consumers recognize its value. The innovating firm builds new factories to expand its capacity and satisfy domestic and foreign demand for the product.
- In stage 3, the standardized product stage, the market for the product stabilizes. The product becomes more of a commodity, and firms are pressured to lower their manufacturing costs as much as possible by shifting production to facilities in countries with low labor costs. As a result, the product begins to be imported into the innovating firm's home market.

According to the international product life cycle theory, domestic production begins in stage 1, peaks in stage 2, and slumps in stage 3. Exports by the innovating firm's country also begin in stage 1 and peak in stage 2. By stage 3, however, the innovating firm's country becomes a net importer of the product. Foreign competition begins to emerge toward the end of stage 1, as firms in other industrialized countries recognize the product's market potential. In stage 2, foreign competitors expand their productive capacity, thus servicing an increasing portion of their home markets and perhaps becoming net exporters. As competition intensifies in stage 2, however, the innovating firm and its domestic and foreign rivals seek to lower their production costs by shifting production to low-cost sites in less-developed countries. Eventually, in stage 3, the less-developed countries may become net exporters of the product.

The Theory has been used to describe how the personal computer (PC) went through its product cycle. The PC was a new product in USA in the 1970s and developed into a mature product during the 1980s and 1990s. Today, the PC is in the standardized product stage, and the majority of manufacturing and production process is done in low-cost countries in Asia and Mexico.

2. Theories of International Trade

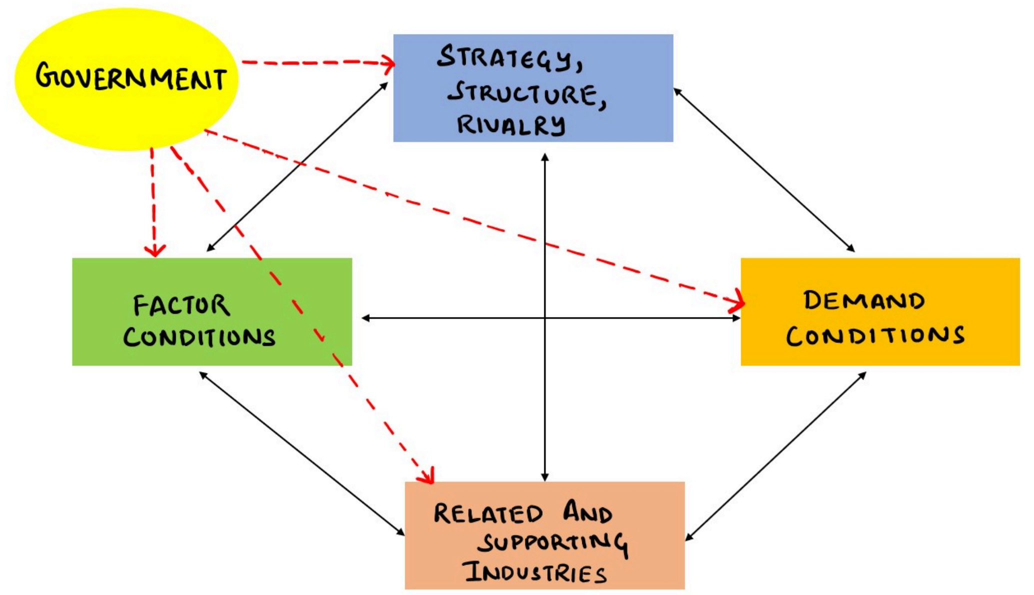
The Global Strategic Rivalry Theory of international trade was developed as a means to ‘examine the impact on trade flows arising from global strategic rivalry between MNCs’. It was an extension of Linder’s analysis by incorporating the impact of economies of scale on trade in differentiated goods. Economies of scale occur if a firm’s average costs of producing a good decrease as its output of that good increases. In industries in which economies of scale are important, we would expect firms to be particularly aggressive in expanding beyond their domestic markets. Like Linder’s approach, this theory predicts that intra-industry trade will be commonplace. Often, firms seek to harness some sustainable competitive advantage they enjoy as a means of leveraging their own strengths and neutralizing those of their rivals. It explores the notion that in order to stay viable, firms should exploit their ‘competitive advantage’ globally and try to keep it sustainable.

Firms competing in the global marketplace have numerous ways of obtaining a sustainable competitive advantage like:

- owning intellectual property rights
- investing in research and development
- achieving economies of scale or scope
- exploiting the experience or learning curve
- forging strategic alliances and strategic mergers and acquisitions.

2. Theories of International Trade

The Diamond model of Michael Porter for the Competitive Advantage of Nations offers a model that can help understand the competitive position of a nation in global competition. As propounded by Porter, in the competitive advantage of nations, this theory concentrates on a firm's home country environment, as a main source of competencies and innovations. This model can also be used for other major geographic regions. Porter describes 4 keys to a nation's competitive advantage relative to other countries:



(i) Factor Conditions: The nation's relative position in vital industrial production factors such as skilled labour or infrastructure, are important determinants of national competitiveness. Both the level of individual factors and the overall composition of the resource mix must be considered. Factors can be country specific or industry specific. For example, Japan's large pool of engineers reflected by a much higher number of engineering graduates per capita than almost any other nation has been vital to Japan's success in many manufacturing industries.

(ii) Demand Conditions: The nature of home demand for an industry's products and services requires considering both the quantity and quality of the demand. The existence of a large, sophisticated domestic consumer base often stimulates the development and distribution of innovative products as firms struggle for dominance in their domestic markets. In meeting their domestic customers' needs, however, firms continually develop and fine-tune products that also can be marketed internationally. Thus, pioneering firms can stay ahead of their international competitors as well. For example, Japan's sophisticated and knowledgeable buyers of cameras helped stimulate the Japanese camera industry to improve product quality and to launch new, innovative models.

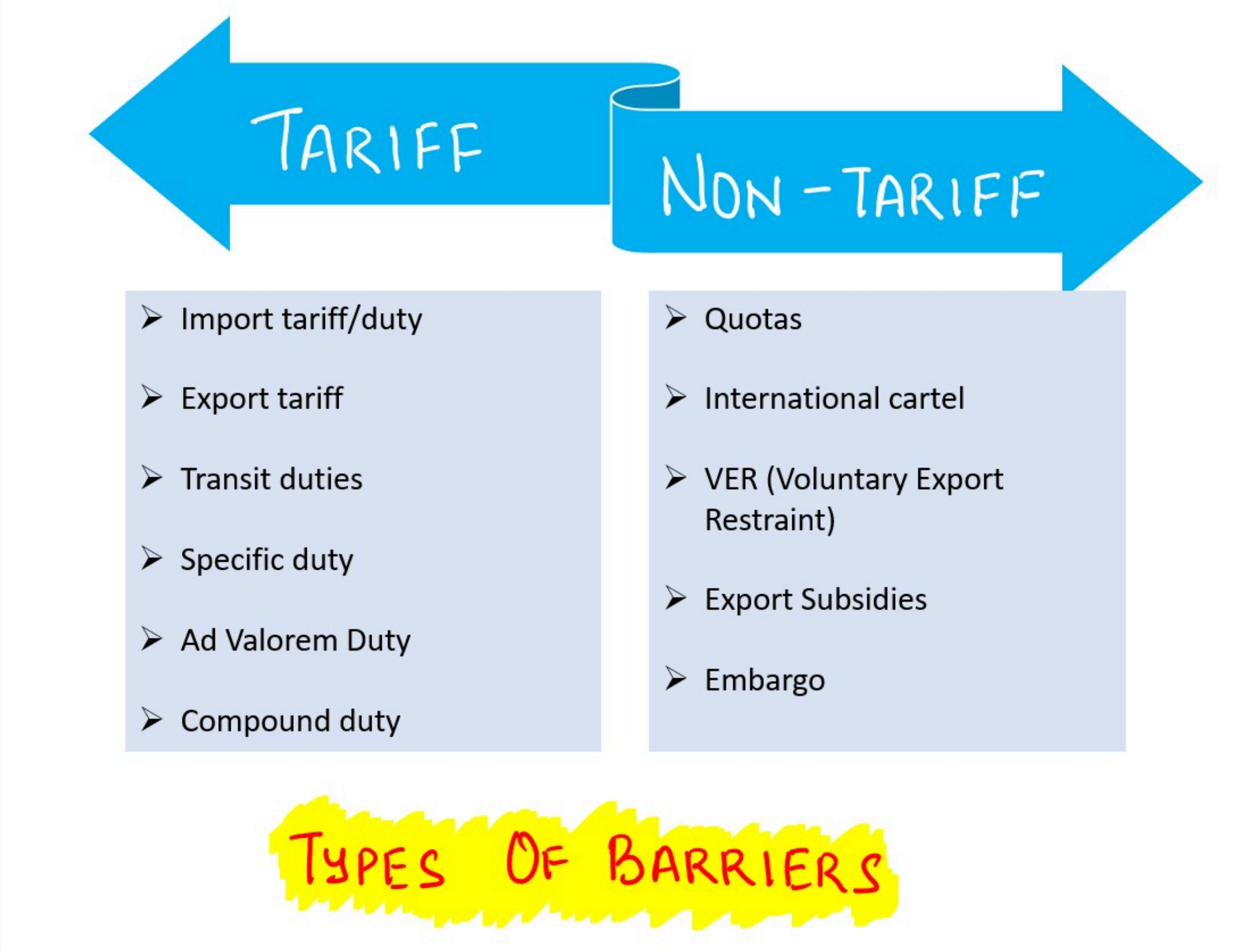
(iii) Related and Supporting Industries: The emergence of an industry often stimulates the development of local suppliers eager to meet that industry's production, marketing, and distribution needs. An industry located close to its suppliers will enjoy better communication and the exchange of cost-saving ideas and inventions with those suppliers. Competition among these input suppliers leads to lower prices, higher-quality products, and technological innovations in the input market, in turn reinforcing the industry's competitive advantage in world markets. The presence or absence in the nation of internationally competitive supplier and related industries is a key factor.

(iv) Company Strategy, Structure and Rivalry: The national conditions determine how companies are created, organised and managed, as well as the nature and extent of domestic rivalry. To survive, firms facing vigorous competition domestically must continuously strive to reduce costs, boost product quality, raise productivity, and develop innovative products. Firms that have been tested in this way often develop the skills needed to succeed internationally. For example, the predominance of engineers on the top-management teams of German and Japanese firms results in emphasizing the improvement of the manufacturing processes and product design. Furthermore, domestic rivalry creates pressure to launch new products, to improve quality, to reduce costs and to invest in new, more advanced technologies.

3. Tariff and non-Tariff Barriers

The countries use protectionism (protecting against imports) in various forms. These can be divided into two barriers:

1. Tariff Barriers
2. Non-Tariff Barriers



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3. Tariff and non-Tariff Barriers

Tariff is a custom, duty or tax imposed on products that move across borders. It is the most common instrument used for controlling imports and exports. Tariffs reduce supply and raise the price of imports. This gives domestic equivalents a comparative advantage. As such, tariffs are distorting the market forces and may prevent consumers from gaining the benefit of all the advantages of international specialisation and trade.

- **Import tariff/duty:** Custom duty imposed by the importing country in the form of a tax imposed on goods being imported.
- **Export tariff:** Duty imposed on goods by the exporting country on its exports.
- **Transit duties:** It is levied on commodities that originate in one country, cross another and are consigned to another.
- **Specific duty:** It is based on specific attribute (physical characteristics like weight) of goods and is usually expressed as sum per unit.
- **Ad Valorem duty:** Duty imposed according to the value of commodities being traded between countries, usually a fixed percentage of the invoice value of the goods. They are also called Export Visas.
- **Compound duty:** Combination of specific duty and ad valorem duty on a single product.

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3. Tariff and non-Tariff Barriers

These are non-tax restrictions, such as, Government policies and regulations. It can be in various form like quotas, subsidies, embargo, etc.

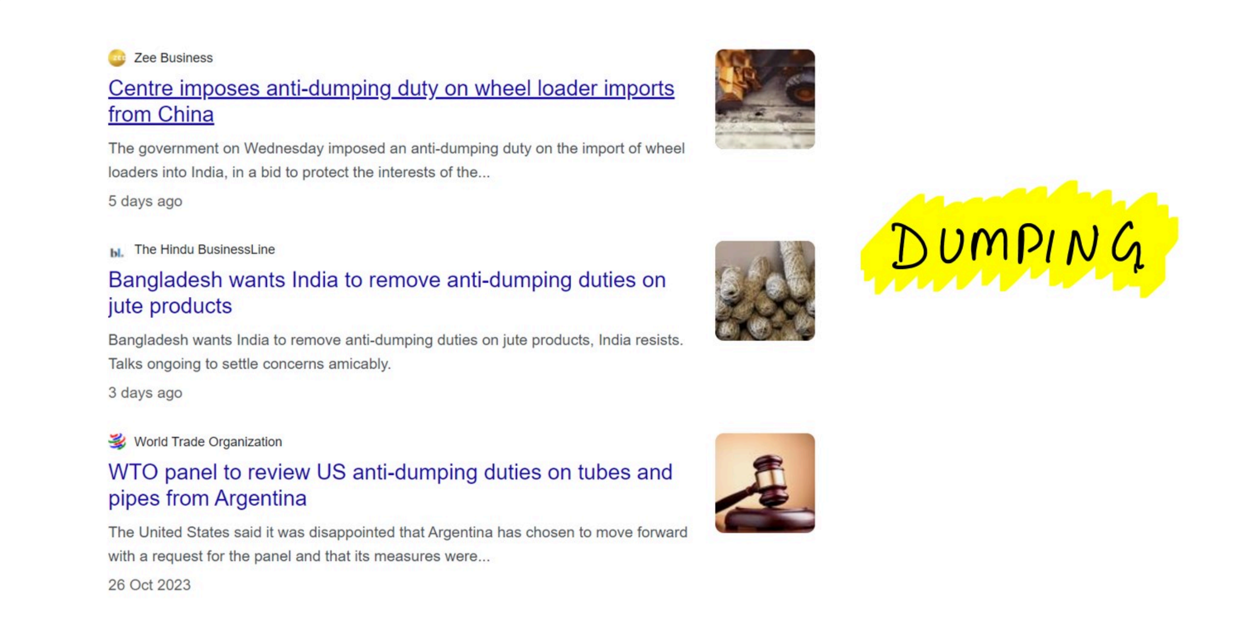
- **Quotas**: Numerical limit on the quantity of goods that can be imported or exported during a specified time period.
- **International cartel:** An international cartel is an organization of suppliers of a commodity located in different nations (or a group of governments) that agrees to restrict output and exports of the commodity with the aim of maximizing or increasing the total profits of the organization. The most famous example is OPEC (Organization of Petroleum Exporting Countries), which, by restricting production and exports, succeeded in quadrupling the price of crude oil between 1973 and 1974. Another example is the International Air Transport Association, a cartel of major international airlines that met annually until 2007 to set international air fares and policies.
- **VER (Voluntary Export Restraint):** Quota on exports fixed by the exporting country on the request of the importing country, in form of maximum amount of quantity that will be exported to the destination country.
- **Export Subsidies:** Payment made by the Government to the domestic producer so that they can compete against the foreign goods. It can be cash grant, subsidized input prices, tax holiday etc. Countervailing duties (CVDs) are often imposed on imports to offset export subsidies by foreign governments.
- **Embargo:** Complete ban on import or export of a particular commodity.

Countries also use various other non-tariff barriers to protect themselves from foreign competition. These barriers are more difficult to eliminate than tariffs and quotas because they often are embedded in bureaucratic procedures and are not quickly changeable. The most common are:

- Product and testing standards
- Restricted access to distribution networks
- Public-sector procurement policies
- Local-purchase requirements
- Regulatory controls
- Currency controls
- Investment controls

The government policies that promote international trade, including subsidies, establishment of foreign trade zones, and export financing programs.

4. Dumping



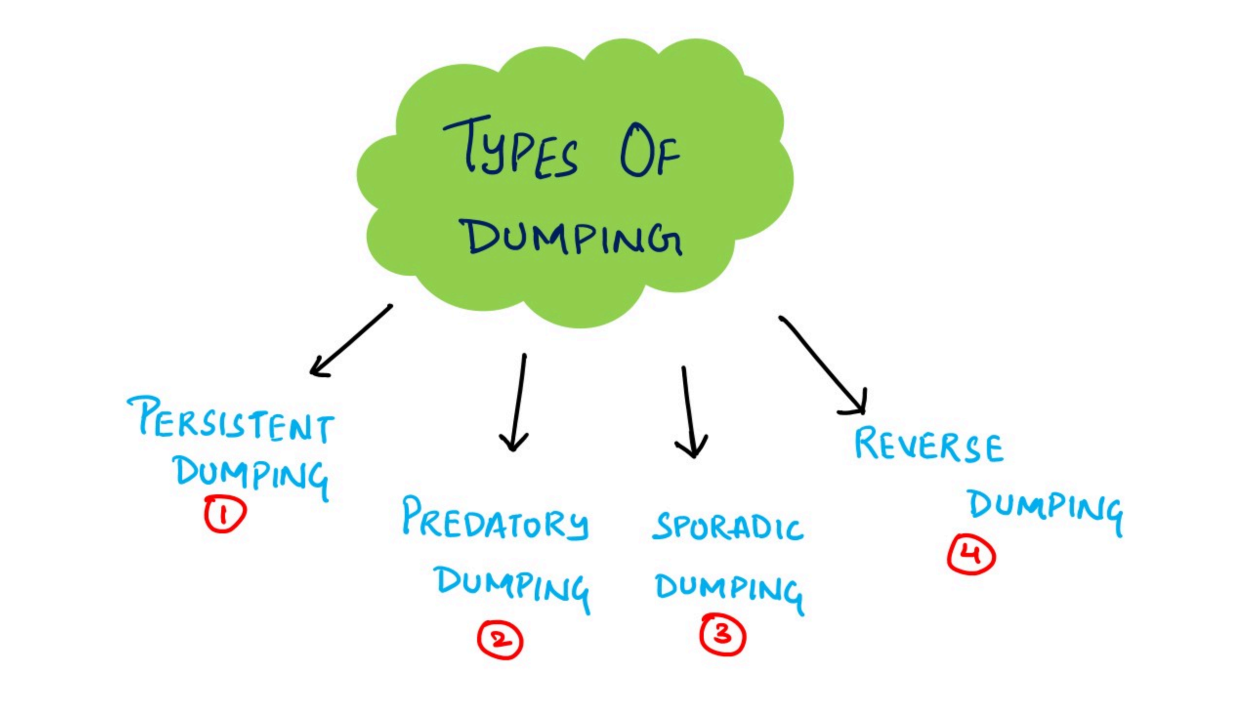
Dumping is, in general, a situation of international price discrimination, where the price of a product when sold in the importing country is less than the price of that product in the market of the exporting country. **Anti-Dumping duty** is a penalty imposed on suspiciously low-priced imports, to increase their price in the importing country and so protect local industry from unfair competition. Anti-dumping duties are assessed generally in an amount equal to the difference between the importing country's FOB (Free on Board) price of the goods (at the time of their importation) and the market value of similar goods in the exporting country or other countries. **FOB (Free on Board)** Price is the price quoted by a seller and includes all charges up to placing the goods on board in a ship at the port of departure specified by the buyer. It is also called collect freight, freight collect, or freight forward.

In Uruguay Round, for the first time, a **Sunset Clause** was included in the Anti-Dumping Agreement (Article VI of GATT relates to anti-dumping). According to this clause, the antidumping order expires when the 5-year period has elapsed and only in exceptional circumstances can the duty be continued.

For example, in Sep 2023, India imposed an anti-dumping duty on some types of steel imports from China for 5 years to remove "injury" to the domestic industry. Similarly, in April 2021, India imposed anti-dumping duty on imports of flexible slabstock polyol from Saudi Arabia and UAE for a period of 5 years.

In India, the **Directorate General of Trade Remedies (DGTR)** conducts anti-dumping investigations, under the Customs Tariff Act, 1975.

4. Dumping



Types of dumping are:

1. Persistent dumping, or international price discrimination, is the continuous tendency of a domestic monopolist to maximize total profits by selling the commodity at a higher price in the domestic market (which is insulated by transportation costs and trade barriers) than internationally (where it must meet the competition of foreign producers).

2. Predatory dumping (also called Intermittent dumping) is the temporary sale of a commodity at below cost or at a lower price abroad in order to drive foreign producers out of business, after which prices are raised to take advantage of the newly acquired monopoly power abroad.

3. Sporadic dumping is the occasional sale of a commodity at below cost or at a lower price abroad than domestically in order to unload an unforeseen and temporary surplus of the commodity without having to reduce domestic prices.

4. Reverse dumping is followed in the overseas markets where the demand is less elastic. Such markets tolerate a higher price. Thus, dumping is done in the manufacturer's home market by selling locally at a lower price.

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5. Government Control over Trade

Free trade at an international level means that this freedom is true for trade between all countries. In this way, countries gain the benefits from competition that exist where the national markets are free from barriers and restrictions. Thus, Free trade may be beneficial, but governments will often be under intense pressure to protect against overseas imports, to prevent the loss of domestic jobs. Thus, they see protection against imports as an answer to this, at least in the short-term. Protectionism, therefore, is one of tools used by the government for controlling international trade.

5. Government Control over Trade

The main reasons why government protects trade includes:

- **Safeguard domestic employment** - They maintain higher levels of domestic production.
- **Correct balance of payments disequilibrium** – By dampening the demand for imports and promoting exports.
- **Prevent labour exploitation in developing economies** - This is really a moral argument as it rests on making imports more accurately reflect their true cost of production. However, it might also reduce imports from some of the poorest economies in the world.
- **Prevent dumping** – Dumping is the process by which economies sell goods in overseas markets at a price below the cost of production. Domestic consumers pay more than those buying overseas. Such low prices are part of a policy to destroy rivals in export markets.
- **Safeguard infant industries** - As shifts in comparative advantages arise, some countries become able to enter new markets. These fledgling industries needs some protection from the power of already established competitors.
- **Enable a developing country to diversify** - This is similar to the infant industries argument. Many developing countries are heavily dependent on exports of primary commodities. This can leave them very exposed to changes in international commodity prices. If they want to diversify and develop new export revenue streams, they may need to protect these new industries from full exposure to international competition for a while.
- **Source of government revenue** - Where protectionism takes the form of a tariff, apart from reducing demand for imports via the impact of a higher price, this will also raise revenue for the government, like any other tax. The revenue raising function will be most successful where the demand for imports is price inelastic.
- **Strategic arguments** - A particular product or industry might be of strategic importance to a country, e.g., agriculture or coal, and protectionism may be justified on the grounds that it is keeping alive an industry which plays a vital part in the economy, perhaps because of social, political or military reasons.

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5. Government Control over Trade

Although protection is often seen as a convenient political solution for countries (and has been extensively used even in recent years), it does also have a number of problems. This means that it is not always the best solution for a country. These problems include:

- **Downward multiplier effects** - If a country successfully protects against imports, this will reduce the level of imports. However, one country's imports are another country's exports and this reduction in exports will lead to a multiplied effect. This may even reduce demand for exports from the country that raised the protectionist measures in the first place but will certainly reduce world output.
- **Retaliation** - Any protectionist measure tends to be instantly met with some form of retaliation by the other countries. This means that any success in protecting against imports will lead to a fall in exports with that country.
- **Costs** - Tariffs (and other protectionist measures) tend to lead to a cost on society as they lead to reduction in imports. Some of the benefits from the reduced imports are passed to domestic firms in the form of higher prices and the government in the form of revenue, but the triangles either side of the shaded area represent a welfare cost to society. Consumers will be paying higher prices for many of the goods and services they consume.
- **Inefficiency of resource allocation** - The imposition of tariffs or other protection may not be the best solution. Firms may be able to shelter behind the tariff wall and remain inefficient. They may not have an incentive to reduce costs and become fully globally competitive if they believe that the tariffs will continue. This will be true also where infant industries are protected. If the tariffs remain in the long-term, the infant industry may never ‘grow-up’. Firms operating with higher costs may be unable to achieve export competitiveness. In short, resources will not be allocated to their most efficient uses.
- **Bureaucracy** - Many protectionist measures are very bureaucratic to enforce. This is likely to reduce choice for domestic consumers and perhaps lead to possible corruption and other administrative costs. These will not be beneficial for the economy.

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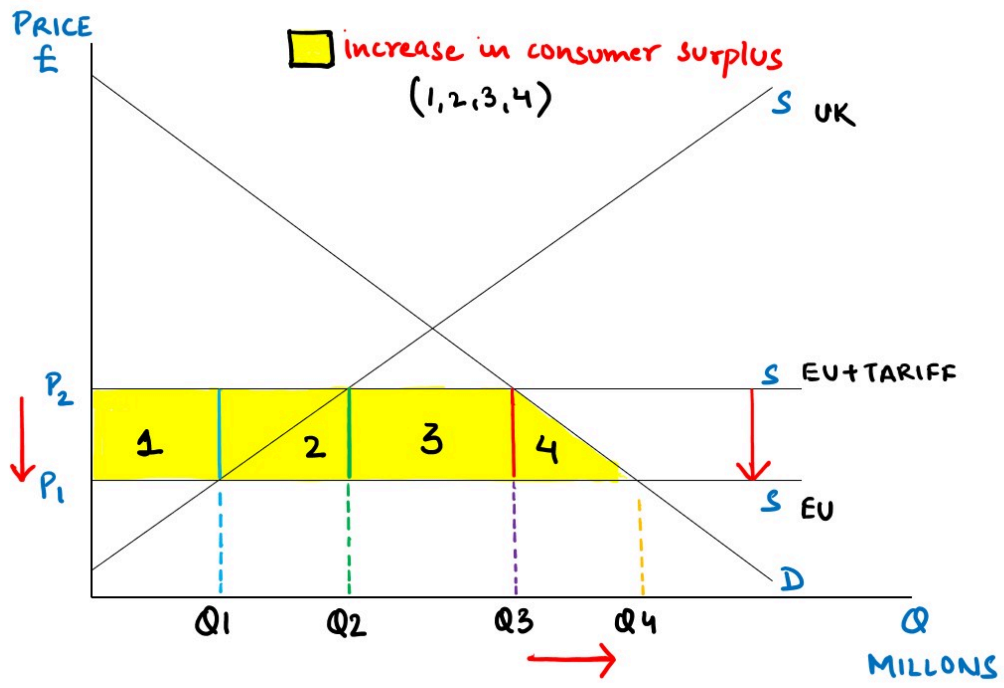
6. Trade Creation and Diversion

Trade Creation and Trade Diversion terms were used by 'old' Chicago School economist **Jacob Viner** in his 1950 paper **The Customs Union Issue.**

6. Trade Creation and Diversion

The **Trade creation** refers to the **increase in economic welfare from joining a free trade area**, such as a customs union.

Trade creation will occur when there is a reduction in tariff barriers, leading to lower prices. This switch to lower cost producers will lead to an increase in consumer surplus and economic welfare. It is important to understand the diagram of Trade Creation. X axis represents the Quantity and Y axis represents the Prices. The line from left bottom to top right represents the Supply of a good. The line from top left to bottom right represents the Demand of a good.

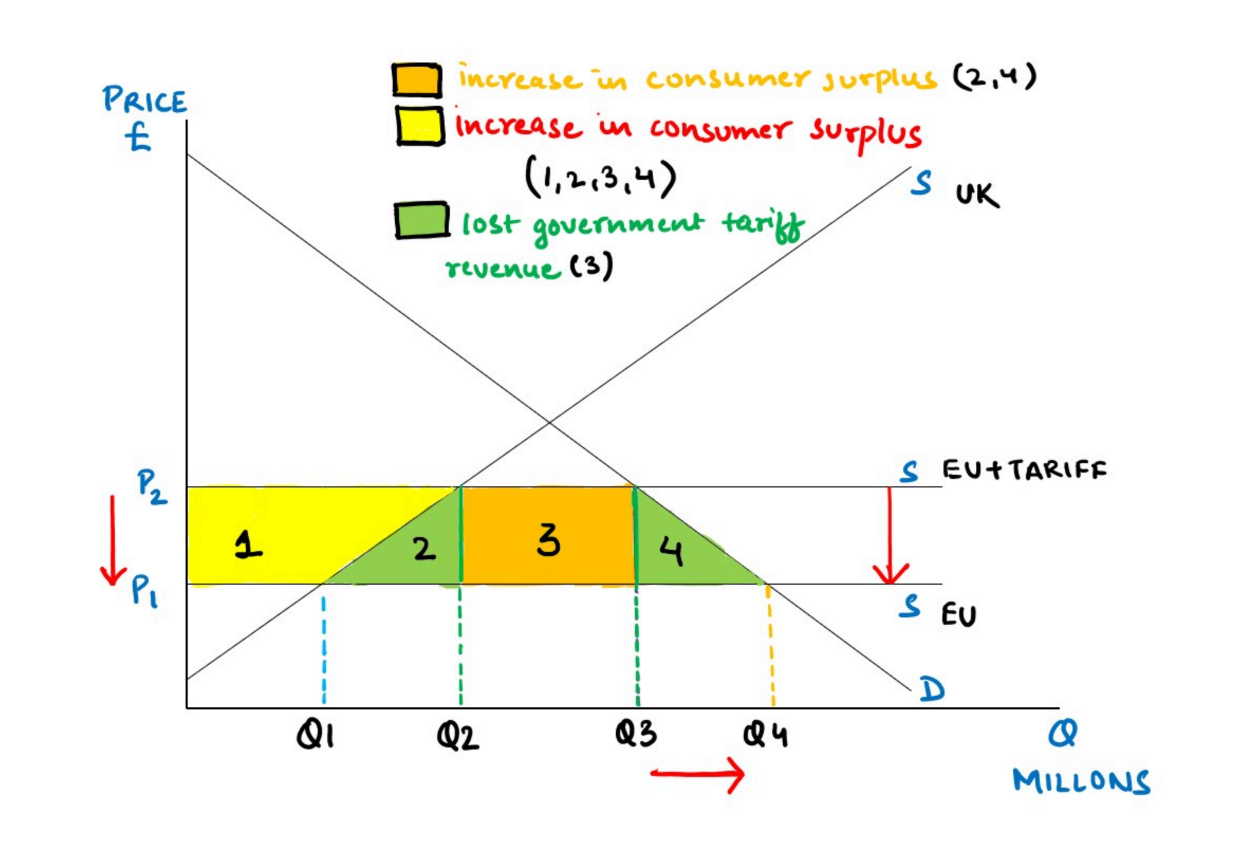


P_2 represents the price, before joining any custom union (or Free Trade Area), which includes the import tariff. Now suppose, the UK joins some custom union (say EU). Because of tariff free trade, now the price will come down from P_2 to P_1. Please note in the diagram that the Quantity bought will rise from Q_3 to Q_4, with reduction of price. Therefore, there is an increase in consumer surplus, equal to area 1+2+3+4.

But this also has impact on the (a) domestic producers and (b) government tariff revenue. As, we can see from the diagram below, because of price line coming down from P_2 to P_1, the domestic consumers will sell less as consumers buy cheaper imports. This reduction in Producer surplus is shown by area 1, in the diagram below. Accordingly, the Government will lose tax revenue (from import tariffs), which is shown by the area 3.

The **net welfare gain** is equal to area 2+4 (increase in consumer surplus and producer surplus).

It may be noted that the impact of trade creation will depend upon the elasticity of demand and supply. If demand and supply are inelastic, the net gain will be much lower.



However, there are more potential benefits of reducing tariffs. If you cut import tariffs, other countries are likely to reciprocate and reduce tariffs on your exports. Therefore, there will also be an extra benefit from increased exports.

6. Trade Creation and Diversion

Trade diversion occurs when tariff agreements cause imports to shift from low-cost countries to higher cost countries. Trade diversion is considered undesirable because it concentrates production in countries with a higher opportunity cost and lower comparative advantage.

Trade diversion may occur when a country joins a **free trade area** with a **common external tariff.**

Consider the diagram, Suppose the UK place a tariff on the import of cauliflowers to all countries equally. There is an equal tariff to European countries (EU) and equal tariff to Australia.

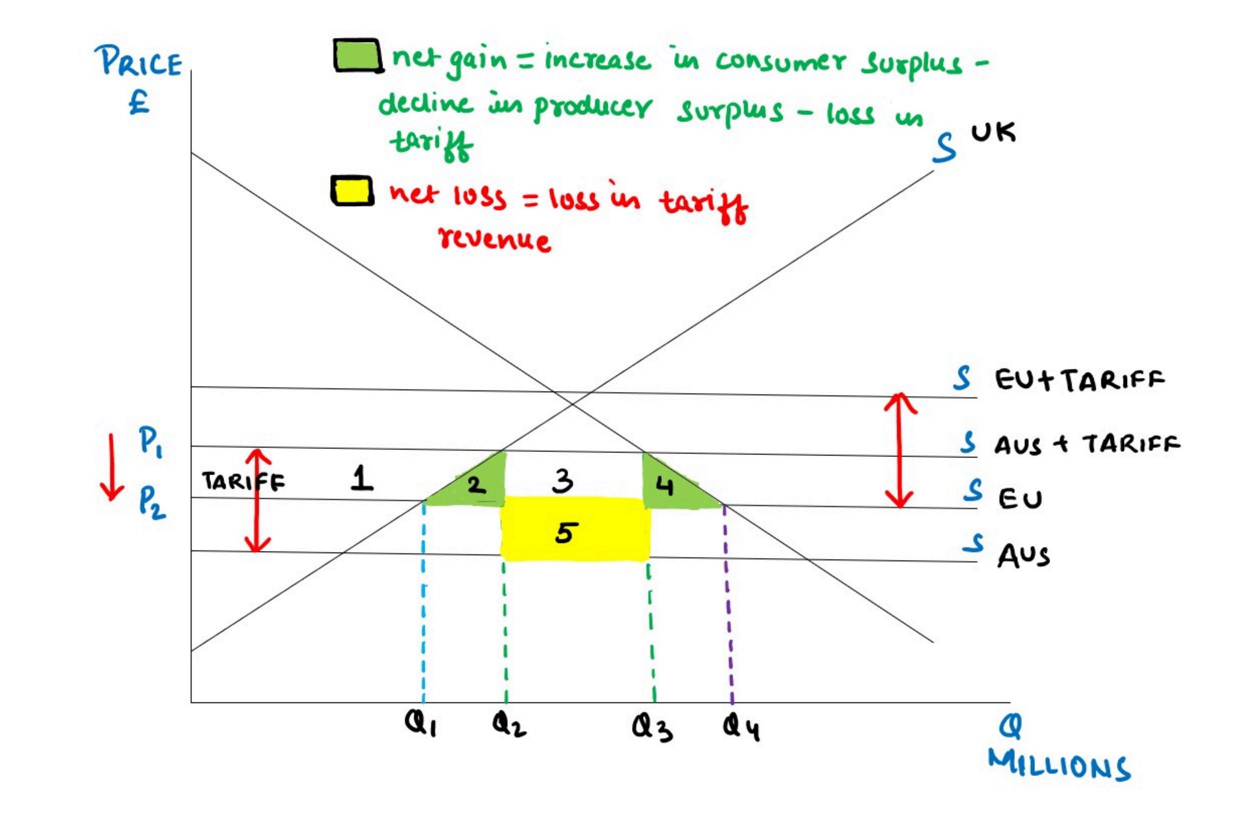
In this case, the UK will import from Australia at a price of P_1(which is cost of production for Australia plus tariff imposed by the UK) as we can see from diagram that the cost of production for Australia (S_{Aus}) is lower than cost of production for EU (S_{EU}) .

The UK government gets tariff revenue, which is shown by areas 3 + 5.
The Consumers will pay a price of P_1. The total quantity of cauliflowers will be Q_3, out of which the domestic producers will sell Q_2.

UK Joins the Customs Union (EU)
Now suppose the UK joins Customs Union, EU. After joining the customs union, the UK abolishes tariffs with EU, but not Australia (because Australia is outside Custom Union EU).
Thus, the price of importing cauliflower from the EU falls to P_2 (which is cost of production for EU, represented by S_{EU}).

Net Gain = increase in consumer surplus - decline in producer surplus - loss in tariff.
Net Loss = loss in tariff revenue

Because of this reduction in price, the Consumers will gain with an increase in **consumer surplus** of areas 1 + 2 + 3 + 4. Thus, the **Consumer gain** is represented by the area 1 + 2 + 3 + 4
Further the UK domestic producers sell less they only sell Q_1, as we now import more Q_4 - Q_1. Thus, **Producer loss** is represented by area 1.



The **government loses tariff** equal to area of 3 + 5.

Net Gain = increase in consumer surplus - decline in producer surplus - loss in tariff.
= (1 + 2 + 3 + 4) – (1) – (3 + 5)
= (2 + 4) – 5

In the present example, 5 is greater than 2 + 4. So, there is a net welfare loss to the UK even though consumers benefit from lower prices. But if the area 2+4 was greater than 5 it would be net welfare gain. This depends on the elasticity of demand.

Overall welfare effects

- Australian farmers lose out. Exports fall.
- EU farmers gain
- The global economy loses out because we have shifted from low-cost producers Australia to relatively high-cost producers the EU.

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6. Trade Creation and Diversion

Thus, we can sum up:

Trade Creation: Production shifts to more efficient producers for reasons of comparative advantage, allowing consumers access to more goods at lower prices than it would have been possible without integration. Companies protected in their domestic markets face real problems when the barriers are eliminated, and they attempt to compete with more efficient producers. The strategic implication is that companies that were unable to export to another country even though they might be more efficient than producers there are now able to export when the barriers come down, creating more demand for their products and less for the protected ones. Investment also might shift to countries that are more efficient or that have a comparative advantage in one or more factors of production.

Trade Diversion: Trade shifts to countries in the group at the expense of trade with other countries, even though the nonmember companies might be more efficient in the absence of trade barriers.

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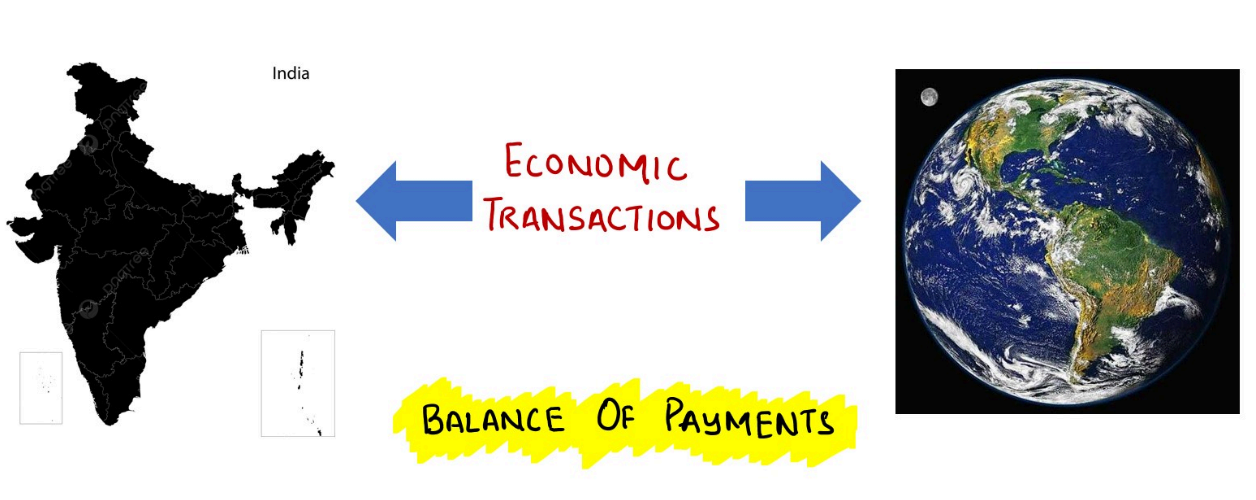
1. Introduction



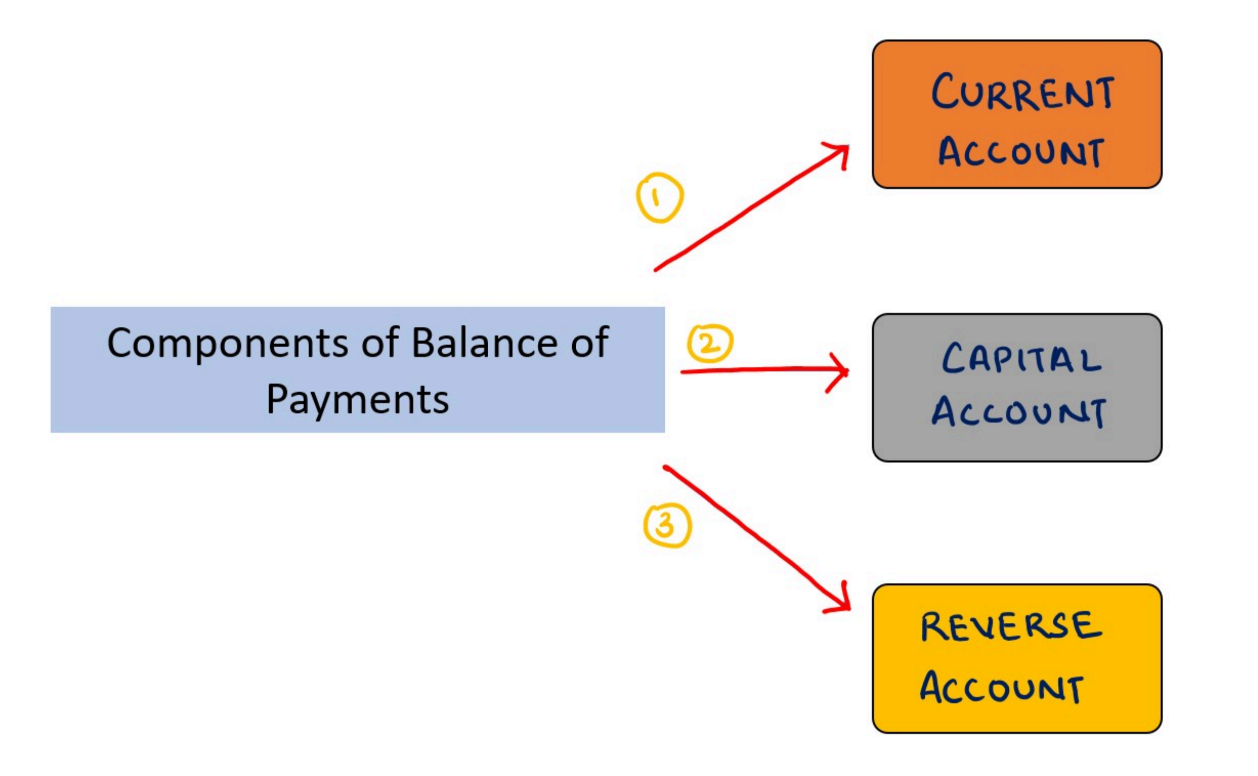
An open economy can be referred to as an economy that interacts freely with other economies around the world. An open economy interacts with other countries by buying and selling goods and services in world product markets and buying and selling capital assets in world financial markets.

Foreign trade influences the aggregate demand of a country in 2 ways, **Leakage** and **Injection**.

When the residents of a country buy foreign goods, the amount of money spent that escapes from the circular flow of income are known as **Leakage**. It decreases the aggregate demand. Thus, leakage is a diversion of funds from the iterative process of circular flow of income. The exports made by a country to foreigners can be described as an **Injection** into the circular flow of income thereby increasing aggregate demand for goods produced within the domestic economy.

The Balance of Payments (BOP) summarizes the transactions that a country's individuals, companies and government bodies conclude with individuals, companies and government bodies outside the country. These transactions consist of imports and exports of goods, services and capital. Transfer payments, such as foreign aid and remittances are also a part of such transactions. Thus, the Balance of Payment takes into account all the transaction with the rest of the world.

2. Components of BOP



The Balance of Payments is a collection of accounts conventionally grouped into 3 main categories with subdivisions in each. We will discuss these next:

1. Current Account
2. Capital Account
3. Reverse Account

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2. Components of BOP

Current Account records all items of flow nature. Current Account consists of:

1. **Export and Import of goods:** Current Account shows imports and exports of visible items goods. For example, steel, machinery, etc.
2. **Export and Import of Services:** Current Account shows export and import of invisible items. For example, services like banking, insurance, etc.
3. **Unilateral or Unrequired Transfer:** Unilateral or Unrequired Transfer are receipts which the residents of a country receive or pay, for which they do not have to do anything in return.

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2. Components of BOP

Capital Account records all items of stock nature. The components are:

1. **Direct Investment:** Direct investment means purchasing an asset and acquiring control of it. For example, Foreign Direct Investment (FDI), Equity capital, Reinvested Earnings and other direct capital flows.
2. **Portfolio Investment:** It is the acquisition of an asset that does not give the purchaser control over the asset, like purchase of shares in a foreign company. For example, Foreign Institutional Investments, Offshore funds.
3. **External Borrowings:** External Commercial Borrowings, Short term debt. (**External Commercial Borrowings** are commercial loans raised by eligible resident entities from recognised non-resident entities and should confirm to RBI parameters such as minimum maturity, permitted and non-permitted end-uses, maximum all-in-cost ceiling, etc.)
4. **External Assistance:** Government Aid, Inter governmental, multilateral and bilateral loans.

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2. Components of BOP

In principle, this is not different from the capital account in as much as it relates to financial assets and liabilities. However, in this category, only reserve assets are included. These are the assets which the central bank of the country uses to settle the deficits and surpluses that arises in the other two categories. Examples are IMF account, Special Drawing Rights (SDR) and Reserve and Monetary Gold.

The current account is sometimes decomposed into the sum of the **trade account** and **international reserves.**

The **trade account** is a broader concept than the "merchandise trade balance" because the former includes trade in economic services such as education, banking, tourism, shipping, insurance and transfers, whereas the latter does not.

The **International reserves** are the assets of a country's central bank that are not denominated in the domestic currency. Gold and assets denominated in foreign currency are the typical international reserves.

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3. Balance of Payment Accounting

The balance of payment is a standard **double entry accounting** record and as such subject to all the rules of double entry book-keeping viz. for every transaction two entries must be made. One credit (+) and one debit (-) and leaving aside errors and omissions, the total of credits must exactly match the total of debits i.e., the balance of payments must always balance.

Simple accounting rules followed in BOP are the following:

- All transactions which lead to an immediate or prospective payment from the rest of the world to the country should be recorded as **credit**. Hence, all payments received for export of goods and services, loans received abroad, inward foreign investment whether direct or portfolio would be credit items.
- Conversely, all transactions which result in an actual or prospective payment from the country to the rest of the world should be recorded as **debits.**
- A transaction which results in an increase in demand for foreign exchange is to be recorded as **debit entry** while a transaction which results in an increase in the supply of foreign exchange is a **credit entry.**

Because the balance of payments system uses a double-entry accounting system, the value of credits on a country's balance of payments must equal to the value of its debits. The overall balance of payments therefore must always sum to zero. If the sum of the credits on a particular account is greater than the sum of the debits on that account, the account is said to be in **Surplus**. If the sum of the debits on a particular account is greater than credits on that account, the account is said to be in **Deficit**.

In case of deficit in BOP, the Central Bank sells foreign exchange reserves in order to balance the BOP. This is called **Official Reserve Sale.**

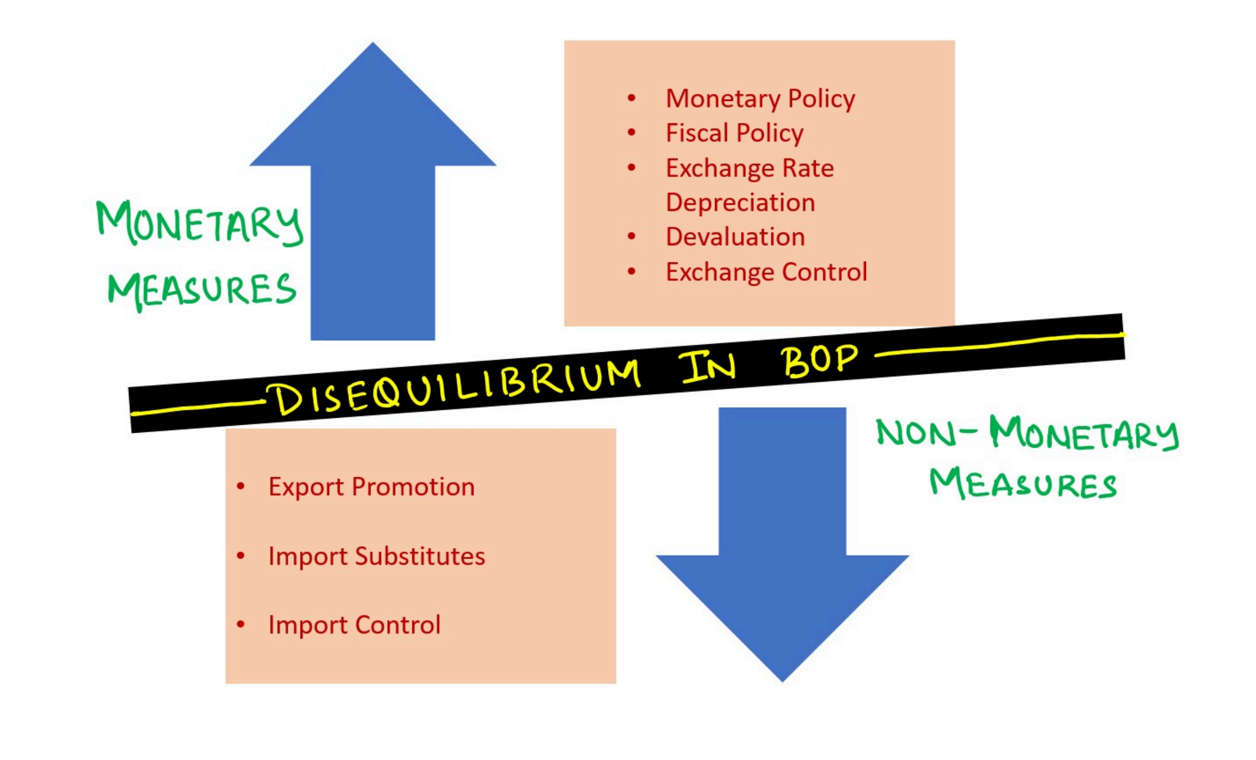
There are some transactions that are done in order to bridge the gap in the balance of payments. These are called **accommodating transactions**. These are also known as 'below the line items'. Therefore, these transactions help to balance the deficit or surplus in the balance of payments. The official reserve transactions are an example of accommodating transactions in the BOP.

Autonomous transactions are independent of the state of BOP. These items are also called 'above the line items' in BOP. The BOP is said to be in surplus, if autonomous receipts are greater than autonomous payments. Accommodating transactions are determined by the net consequences of the autonomous transactions.

Because many balance of payments entries are estimated, the sum of the current account and the capital account does not always equal zero as it should in a double-entry system. If the sum of the current and capital accounts is not zero, statisticians add a balancing item equal to the sum of all the measured items with the sign reversed. This term is called the **statistical discrepancy or errors and omissions.**

4. Disequilibrium in the BOP

The countries can use a combination of monetary and non-monetary measures to correct disequilibrium in the Balance of Payments. The appropriate measures depend on the specific circumstances of each country, and policymakers must consider the short-term and long-term effects of these measures on the economy.



4. Disequilibrium in the BOP

Monetary measures involve actions taken by the central bank to regulate the money supply in the economy. The following are some of the monetary measures that can be used to correct BOP disequilibrium:

1. Monetary Policy: The central bank can expand or contract the money supply in the economy by changing the interest rates. By increasing the interest rates, the central bank can reduce the demand for imports and increase the demand for exports. This helps to reduce the BOP deficit. On the other hand, by decreasing interest rates, the central bank can stimulate domestic demand and boost imports. This can lead to a BOP surplus.

2. Fiscal Policy: Fiscal policy refers to the government's policy on income and expenditure. The government can adopt measures such as increasing taxes, reducing government expenditure, and increasing public savings to reduce the demand for imports and increase the demand for exports. This helps to reduce the BOP deficit.

3. Exchange Rate Depreciation: By reducing the value of the domestic currency, the government can correct the disequilibrium in the BOP in the economy. Exchange rate depreciation reduces the value of the home currency in relation to foreign currency. As a result, imports become costlier, and exports become cheaper. It also leads to inflationary trends in the country.

4. Devaluation: Devaluation is lowering the exchange value of the official currency. When a country devalues its currency, exports become cheaper, and imports become expensive which causes a reduction in the BOP deficit.

5. Exchange Control: All exporters are directed by the monetary authority to surrender their foreign exchange earnings, and the total available foreign exchange is rationed among the licensed importers. The license-holder can import any good, but the amount is fixed by the monetary authority. This helps to regulate the demand for imports and exports and reduce the BOP deficit.

Fiscal means something that is related to public money or taxes. Fiscal policy is an estimate of taxation and government spending that impacts the economy. It can be either expansionary or contractionary. An expansionary fiscal policy is one which is used at the times of an economic slump. Government cuts taxes to spur economic growth. On the other hand, a contractionary fiscal policy is aimed at lowering inflation as it tends to reduce the quantum of money by raising taxes and reducing spending.

Fiscal policy is based on **Keynesian economics**, a theory by economist John Maynard Keynes. This theory states that the governments of nations can play a major role in influencing the productivity levels of the economy of the nation by changing (increasing or decreasing) the tax levels for the public and thus by modifying public spending. Fiscal Policy is implemented by the Government. Monetary Policy is implemented by the RBI.

4. Disequilibrium in the BOP

Non-monetary measures are measures taken by the government to promote exports and control imports. The following are some of the non-monetary measures that can be taken to correct BOP disequilibrium:

1. Export Promotion: Export promotion measures can be taken to stimulate exports. These measures may include reducing export duties, providing cash assistance and subsidies to exporters, and exempting goods meant for export from all types of taxes. These measures help to increase exports and reduce the BOP deficit.

2. Import Substitutes: Steps may be taken to encourage the production of import substitutes. This will save foreign exchange in the short run by replacing the use of imports by these import substitutes. Countries can adopt policies of 'Import Substitution' to reduce the demand for imports and control the BOP deficit.

3. Import Control: Import may be kept in check through the adoption of a wide variety of measures like quotas and tariffs. Under the quota system, the government fixes the maximum quantity of goods and services that can be imported during a particular time period. Tariffs are duties (taxes) imposed on imports. These measures help to reduce the demand for imports and control the BOP deficit.

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5. International Investment Position (IIP)

The **International Investment Position (IIP)** is a financial statement that provides a snapshot of a country's economic relationships with the rest of the world at a specific point in time. It shows the value of financial assets and liabilities that residents of the country hold with foreign entities.

The key components are:

1. **Financial Assets**: These include all investments and financial claims that residents of the country (individuals, companies, or the government) own abroad. Examples of financial assets are:

- Foreign stocks and bonds
- Loans to foreign entities
- Foreign bank deposits
- Direct investments in foreign companies
- Gold bullion held as reserve assets by the central bank

2. **Liabilities**: These are the amounts that the residents of the country owe to non-residents. Liabilities include:

- Foreign investments in the country's stocks and bonds
- Loans from foreign banks or institutions
- Foreign direct investments in domestic companies

The IIP provides valuable information on a country's financial exposure to the global economy. It helps assess:

- **Net Position**: The difference between total financial assets and liabilities gives the net International Investment Position. A positive net position indicates that the country is a net lender to the rest of the world, while a negative position suggests it is a net borrower.
- **Economic Stability**: The IIP can indicate economic strength or vulnerability, as large external liabilities may pose risks during economic downturns.
- **Changes Over Time**: Tracking the IIP over time shows how a country’s international financial engagements evolve.

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6. Importance of BoP

The balance of payments records flows of goods and assets over a period of time, just like the income statement of a firm. By analogy, just as a firm has a balance sheet, at a point in time, a country owns a certain stock of foreign assets, and foreigners own a certain stock of domestic assets. The difference between the values of these two stocks is called **net foreign assets**. Consequently, at any given point in time, a country has a **net international investment position**; it is either a net creditor or a net debtor with the rest of the world.

The value of all the final goods and services produced within a country, within a year, is called the country's **Gross Domestic Product (GDP)**.

The value of what is produced in a country must be purchased either by domestic residents or foreign residents. Hence, the country's total consumption purchases, C, plus its total government purchases, G, plus its total investment purchases, I, plus the value of its net exports, NX, must equal its GDP:
GDP = C + I + G + NX.

The value of all the final goods and services must be paid to factors of production. In an open economy, net factor income from abroad (NFI) from either labor that works in foreign countries or capital that is invested in foreign countries provides a flow of resources that separates gross national income (GNI) from GDP (GNI = GDP + NFI)

By subtracting a country's total expenditures on consumption, investment, and government purchases from its gross national income, we are left with net exports plus net factor income from abroad, which is equal to the **Current Account (CA)** of the balance of payments. If a country has a current account surplus, it must have national income that exceeds national expenditures. If a country has a current account deficit, the country's expenditures exceed its income.

1. Introduction

FDI inflows likely to rise in 2024 as India remains preferred investment destination

Updated - December 24, 2023 at 12:05 PM. | New Delhi

In the January-September period this year, FDI into the country declined 22 per cent to ₹48.98 billion

BY PTI

COMMENTS SHARE FOREIGN INVESTMENT READ LATER

The Capital is one of the key inputs to economic growth. Many economic models directly relate the rate of economic growth to the rate of capital accumulation in an economy.

The **Foreign Investment (FI)** refers to investments made by the residents of one country in the capital assets of another country. In its strictest foreign investment sense, the term 'investment', refers to changes in the stock of capital i.e., plants, machinery, construction, etc. Thus, when foreign nationals invest in establishing capital equipment in India, it constitutes foreign investment.

The **Foreign Direct Investment (FDI)** are medium to long term investments, which add to a country's productive capacity. Characteristically, FDI along with financial investment brings, access to technology and export market. Since FDI involves setting up of production base (in terms of factories, power plant etc.), it generates direct employment in the recipient country. For example, in February 2021, PhonePe, an Indian digital payments platform, raised $700 million in funding from existing investors, including Walmart and Tencent.

Thus, the FDI refers to a relationship between a parent enterprise and its foreign affiliate, the two together forming a Multinational Corporation (MNC). The International Monetary Fund (IMF) defines such control as owning **10% or more of the ordinary shares in the corporation** (or voting power of an incorporated firm (or its equivalent) in the destination country). The FDI can, thus, be more specifically defined as an investment equal to or greater than a 10% equity share in a single firm.

By contrast, the **Foreign Portfolio Investment (FPI)** consists of securities and other financial assets, passively held by the foreign investors. It does not provide the investor direct ownership of the financial assets.

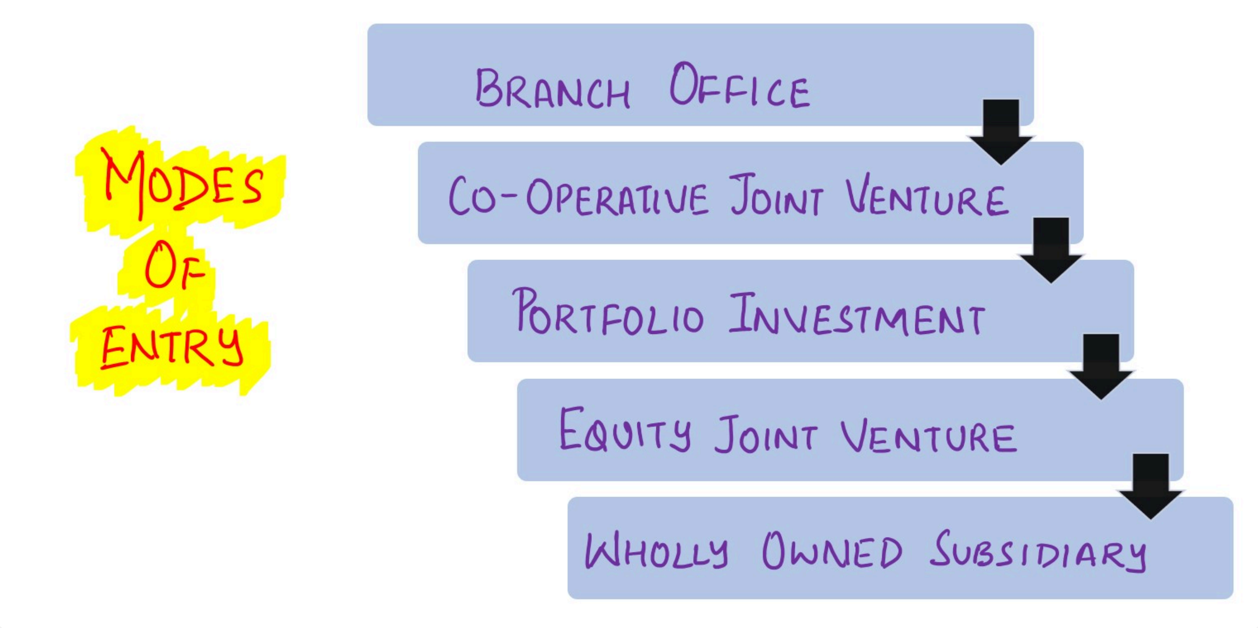
A substantial portion of foreign funds that flow into countries these days, however, flow into secondary markets through financial instruments like equity, bonds, mutual funds, etc. The investments in such secondary market instruments are referred to as **Foreign Institutional Investment (FII)**. The FIIs are also referred to as portfolio investments which are characterised by the features of investments made in secondary market with their total stake in a firm at below 10%.

It is also important to note that the FIIs are characterised by their typically short-term nature of investment. Therefore, unlike the FDIs, they are not intended to enhance the productive capacity of an economy by the creation of capital assets. On the contrary, they are made to make financial gains from differences in rates of return prevailing in the financial markets of different countries. The FIIs or the portfolio investments thus carry a potentially de-stabilizing effect by virtue of their short-term investment nature.

Participatory notes also referred to as **P-Notes**, or PNs, are financial instruments required by investors or hedge funds to invest in Indian securities without having to register with the Securities and Exchange Board of India (SEBI).

2. Mode of Entry

A company can invest in a foreign country through following modes. These are arranged in the order of increasing risk.



1. **Branch office:** An MNC may open a branch office for operating activities, which is fully monitored by the parent company. For example, SBI may open a branch office in New York.
2. **Co-operative joint venture** (also called strategic alliance): This is governed by co-operative agreement between firms for specific purposes like joint research, joint production, technology sharing etc.
3. **Portfolio investment:** This involves investment in equity of another company or lending money through bonds, usually for short term financial gains.
4. **Equity joint venture:** It is a shared ownership in a foreign business, which may be in 50:50 partnership or any other proportion.
5. **Wholly owned subsidiary:** This entry mode involves 100% ownership by a MNC in a venture located in host country.

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3. Types of FDI

The new equity capital flows in the form of FDI generally take one of two forms viz:

1. Green field investment
2. Brown field investment.

Let us discuss them one by one.

3. Types of FDI

When a parent company chooses to begin operations in a foreign country establishing the construction of new production facilities 'from scratch', including all the necessary offices, living quarters and distribution hubs. The developing countries constantly offer various benefits and incentives to call the attention of multinational companies willing to perform Greenfield investments. These benefits include tax breaks, preferential rates for import/export, subsidies and other incentives, which in exchange improves the economy in the target country and enhances the human capital in the area by offering additional job opportunities.

The name '**green**' comes from **building in a pristine literally green new land**, often covered with vegetation prior to the construction and that has never been used for production.

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3. Types of FDI

When a company or government chooses to purchase an already built production facility within a foreign market, this is called a Brownfield investment. The investing company can buy or lease the existing facility eliminating building costs of the project, focusing on remodeling or upgrading, and skipping some of the initial paperwork and requirements from operating with a new property. This sometimes could be a good advantage for new companies as well, and a good short-term startup opportunity.

The name "**brown**" comes from the fact that the **used land may be contaminated by previous activities** from the last existing company. When there is contamination the absence of vegetation is portrayed by a brownfield lacking green, when speaking about a new land which has not been used before for production, that is a Greenfield.

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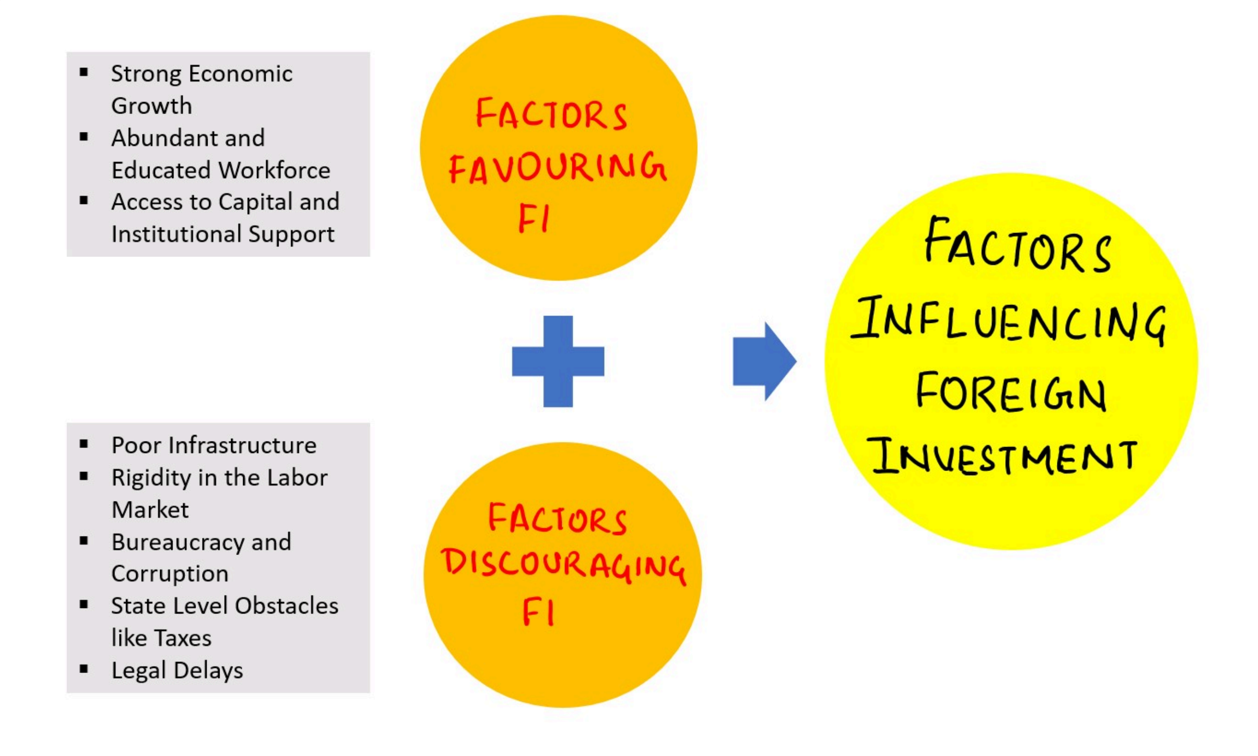
4. Factors influencing Foreign Investment, FI

Foreign Investment (FI) can be influenced by various factors that either encourage or discourage investors from investing in a particular country. These factors can be broadly categorized into two groups: those favoring foreign investment and those discouraging it.



Factors Favoring FI

1. **Strong Economic Growth**: Countries experiencing robust economic growth often attract foreign investors seeking opportunities for higher returns on their investments.

2. **Abundant and Educated Workforce**: A large and well-educated labor force can be an attractive factor for foreign investors. Skilled and knowledgeable workers contribute to productivity and innovation.

3. **Access to Capital and Institutional Support**: Availability of capital, whether through financial institutions or government support, can ease the process of investment and business establishment for foreign investors.

Factors Discouraging FI

1. **Poor Infrastructure:** Inadequate infrastructure, such as unreliable power supply, inefficient transportation, or lack of basic facilities, can deter foreign investors as it affects the smooth operation of businesses.

2. **Rigidity in the Labor Market**: Strict labor laws or inflexible labor markets can make it difficult for investors to adapt to changing business needs or result in higher operational costs due to stringent labor regulations.

3. **Bureaucracy and Corruption**: Excessive bureaucratic hurdles, red tape, and corruption in government procedures can discourage foreign investors due to increased costs, delays, and uncertainties in conducting business.

4. **State-Level Obstacles like Taxes**: Varied tax structures and inconsistent policies among different regions within a country can create confusion and add complexity to foreign investment decisions.

5. **Legal Delays**: Lengthy legal procedures, uncertainty in legal frameworks, and delays in dispute resolution can hinder foreign investment as they increase risks and prolong the process of doing business.

5. Theories of Foreign Investment

Some of the prominent theories of foreign investment are given below:

1. Ownership Advantages
2. Internalization Theory
3. Eclectic Paradigm (1979: John H. Dunning)

Let us discuss them one by one.

5. Theories of Foreign Investment

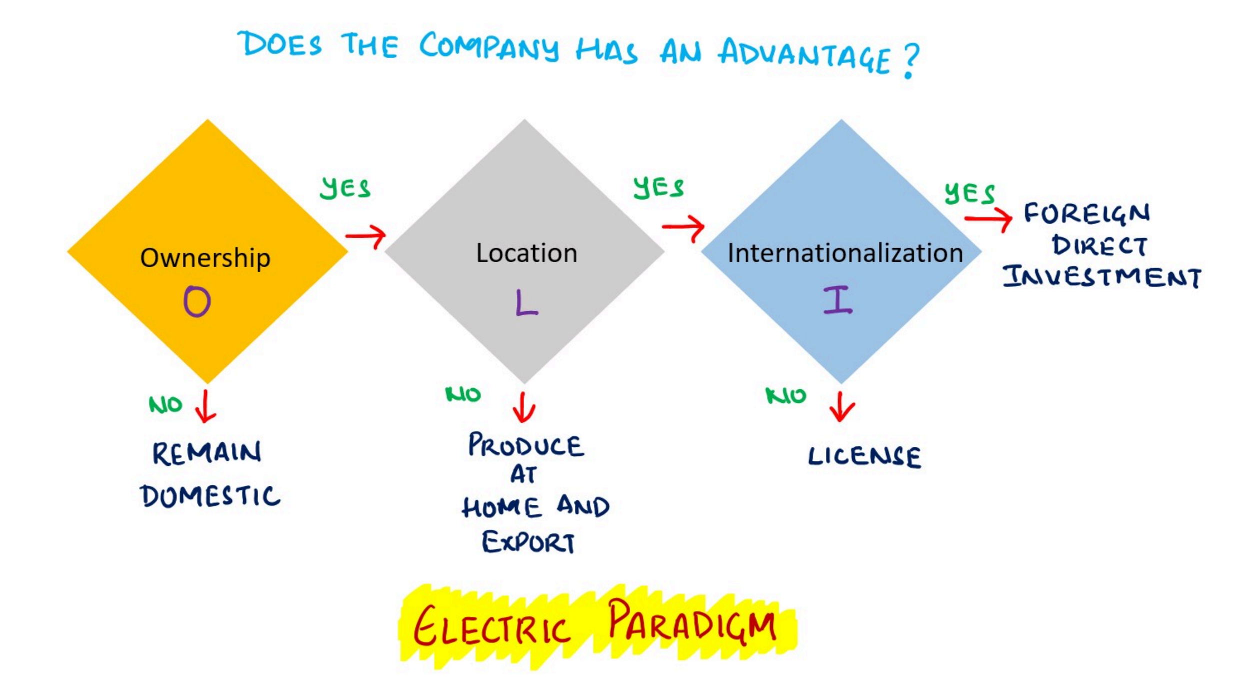
More powerful explanations for FDI focus on the role of the firm. Initially researchers explored how firm ownership of competitive advantages affected FDI. The ownership advantage theory suggests that a firm owning a valuable asset that creates a competitive advantage domestically can use that advantage to penetrate foreign markets through FDI. The asset could be, for example, a superior technology, a well-known brand name, or economies of scale.

5. Theories of Foreign Investment

The ownership advantage theory only partly explains why FDI occurs. It does not explain why a firm would choose to enter a foreign market via FDI rather than exploit its ownership advantages internationally through other means, such as exporting its products, franchising a brand name, or licensing technology to foreign firms. A firm must decide whether it is better to own and operate its own factory overseas or to contract with a foreign firm to do this through a franchise, licensing, or supply agreement. Internalization theory suggests that FDI is more likely to occur when the costs of negotiating, monitoring, and enforcing a contract with a second firm are high.

Conversely, internalization theory holds that when transaction costs are low, firms are more likely to contract with outsiders and internationalize by licensing their brand names or franchising their business operations.

5. Theories of Foreign Investment



An Eclectic Paradigm, also known as the Ownership, Location, Internationalization (OLI) model is a three-tiered evaluation framework that companies can follow when attempting to determine if it is beneficial to pursue Foreign Direct Investment (FDI). It was given by John H. Dunning in 1979.

This theory combines ownership advantage, location advantage, and internalization advantage to form a unified theory of FDI. This theory recognizes that FDI reflects both international business activity and business activity internal to the firm. According to Dunning, production of a firm in a foreign country depends on these 3 conditions:

1. The first consideration, **ownership advantages**, include proprietary information and various ownership rights of a company. These may consist of branding, copyright, trademark or patent rights, plus the use and management of internally available skills. Ownership advantages are typically considered to be intangible. They include that which gives a competitive advantage, such as a reputation for reliability.

2. **Location advantage** is the second necessary consideration. Often fixed in nature, these considerations apply to the availability and costs of resources, when functioning in one location compared to another. Location advantage can refer to natural or created resources, but either way, they are generally immobile, requiring a partnership with a foreign investor in that location to be utilized to full advantage.

3. Finally, **internalization advantages**, signal when it is better for an organization to produce a particular product in-house, versus contracting with a third-party. At times, it may be more cost-effective for an organization to operate from a different market location while they keep doing the work in-house.

6. Benefits and Costs of FDI

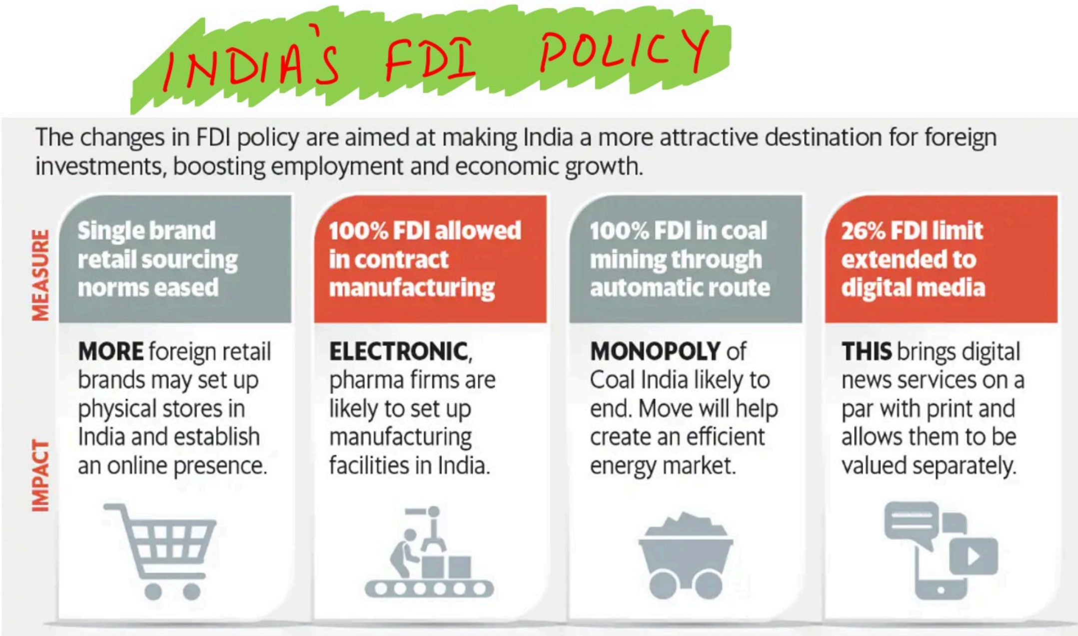
Foreign Direct Investment (FDI) can have both benefits and costs for both the host (receiving) country and the home (source) country.

The host country can benefit from FDI in several ways. Firstly, FDI can bring in capital, technology, and management skills which can accelerate economic growth. Secondly, FDI can create employment opportunities both directly and indirectly, leading to the growth of the host country's economy. Thirdly, FDI can improve the balance of payments of the host country's accounts by substituting imports or exporting goods and services. Lastly, FDI can increase competition in domestic markets, leading to lower prices, greater economic welfare for consumers, and increased productivity growth.

However, there are also costs associated with FDI for the host country. FDI can lead to adverse effects on competition when subsidiaries of foreign MNCs have greater economic power than local firms. Moreover, FDI can lead to an outflow of earnings from the foreign subsidiary to its parent company, leading to a potential adverse effect on the host country's balance of payments position. In addition, some host governments worry that FDI could lead to a loss of economic independence, and they would have no control over decisions made by the foreign parent company.

As for the home country, FDI can lead to increased profits and market share for the company, access to new markets and resources, and spreading risks. However, the home country may face costs such as capital outflow, reduced profits, and loss of technology and management skills.

7. India’s FDI Policy and Trends



To promote Foreign Direct Investment (FDI), the Government has put in place an investor-friendly policy, wherein except for a small negative list, most sectors are open for 100% FDI under the Automatic route. Further, the policy on FDI is reviewed on an ongoing basis, to ensure that India remains attractive & investor friendly destination.

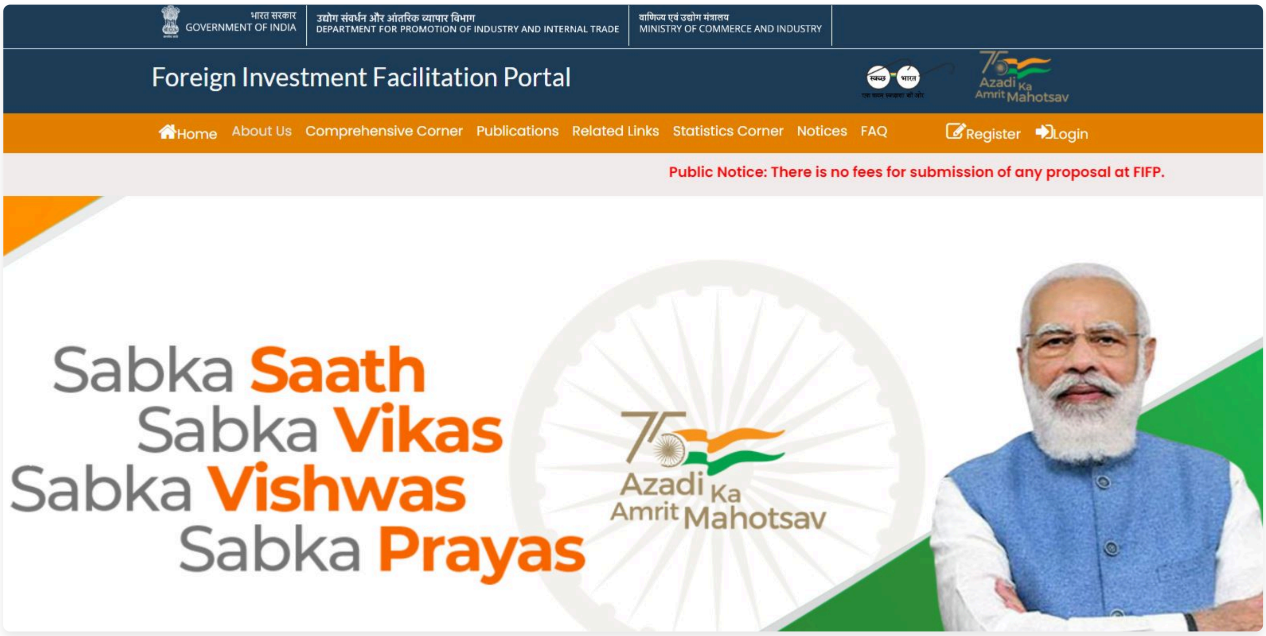
There are 2 routes by which India gets FDI:

1) Automatic route: By this route, the FDI is allowed without prior approval by Government or Reserve Bank of India. The investor just has to inform the RBI after the investment is made.

2) Government route: Prior approval by government is needed via this route. Earlier, the Foreign Investment Promotion Board, FIPB was the responsible agency to oversee this route till 2017. But the FIPB was abolished on May 24, 2017. Now, the approval processes are handled by the concerned Ministries/Departments in consultation with the Department of Industrial Policy & Promotion (DIPP), now renamed as Department for Promotion of Industry and Internal Trade (DPIIT), Ministry of Commerce, which also issues the Standard Operating Procedure (SOP) for processing of applications.

Also, Proposals involving FDI exceeding Rs 50 billion are placed before the Cabinet Committee on Economic Affairs irrespective of sector or country.

7. India’s FDI Policy and Trends



Foreign Investment Facilitation Portal (FIFP) is the new online single point interface of the Government of India for investors to facilitate FDI. This portal is designed to facilitate the single window clearance of applications which are through government approval route. Upon receipt of the FDI application, the concerned Administrative Ministry/Department shall process the application as per the Standard Operation Procedure (SOP).

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7. India’s FDI Policy and Trends

The REITs have been a popular product worldwide for many decades, but guidelines in India were formalized only in last few years by the SEBI. REITs are securities linked to real estate that can be traded on stock exchanges once they get listed. The structure of REITs is similar to that of a mutual fund. Just like mutual funds, there are sponsors, trustees, fund managers and unit holders in REITs. However, unlike mutual funds, where the underlying asset is bonds, stocks and gold, REITs invest in physical real estate. The money collected is deployed in income-generating real estate. This income gets distributed among the unit holders. Besides regular income from rents and leases, gains from capital appreciation of real estate also form an income for the unit holders. In the latest amendment on 1 March 2019, the SEBI reduced the minimum investment limit in REIT to Rs 50,000 from Rs 2 lakh.

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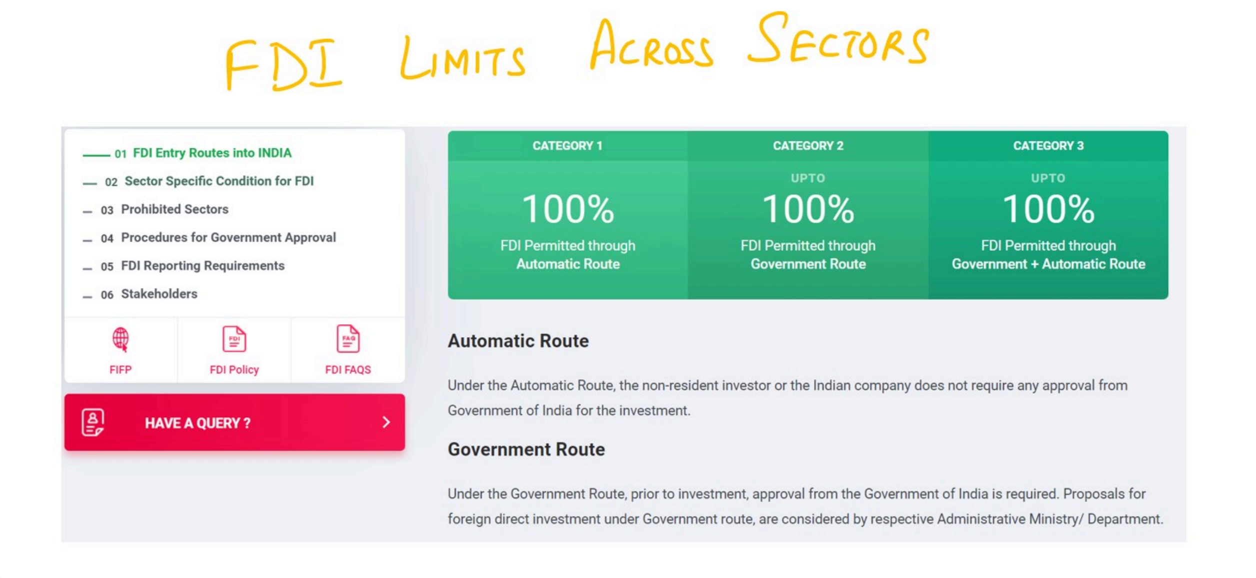
7. India's FDI Policy and Trends



The 11 notified sectors/activities requiring government approval are Mining, Defense / cases relating to FDI in small arms, Broadcasting, Print Media, Civil Aviation, Satellites, Telecom, Private Security Agencies, Trading (Single, Multi brand and Food Products), Financial services not regulated or regulated by more than one regulator/ Banking Public and Private (as per FDI Policy) and Pharmaceuticals.

- The FDI is prohibited in following sector:
- Lottery Business including Government / private lottery, online lotteries, etc.
- Gambling and Betting including casinos etc.
- Chit funds.
- Nidhi Company.
- Trading in Transferable Development Rights (TDRs).
- Real Estate Business or Construction of farmhouses. (Development of townships, residential/commercial premises, roads or bridges and Real Estate Investment Trusts (REITs) is permitted)
- Manufacturing of cigarettes, Cigars, or any tobacco or tobacco substitutes.

Activities/sectors restricted for private sector investment e.g. (i) Atomic energy and (ii) Railway operations (with few exceptions).

Foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also prohibited for Lottery Business, Gambling and Betting activities.

Thus, the FDI policy states that a non-resident entity can invest in India, subject to the FDI Policy except in those sectors/activities which are prohibited. There is one exception. A citizen of Bangladesh and Pakistan or an entity registered in both countries can only invest under the government route. Additionally, for Pakistan sectors/activities such as defense, space and atomic energy are prohibited for investment in addition to the sectors/activities already prohibited.

7. India’s FDI Policy and Trends

Last Consolidated FDI Policy was released by the Government in October 2020. The Government is working on a road map to achieve its goal of US$ 100 billion worth of FDI inflows.

In 2023-24, India received the maximum FDI from Singapore, followed by Mauritius and USA. Among states, Maharashtra had highest FDI, followed by Gujarat and then Karnataka.

Top 5 sectors receiving highest FDI Equity Inflow during FY 2021-22 are Computer Software & Hardware, Services Sector (Fin., Banking, Insurance, Non Fin/Business, Outsourcing, R&D, Courier, Tech. Testing and Analysis, Other), Automobile Industry, Trading and Construction (Infrastructure) Activities.

In Feb 2020, the Department for Promotion of Industry and Internal Trade (DPIIT) allowed 100% FDI in insurance intermediaries through the automatic route. Insurance intermediaries are brokers or agents who liaise between insurance companies and customers. They include insurance brokers, reinsurance brokers, insurance consultants, corporate agents, third-party administrators, and surveyors and loss assessors. The FDI policy earlier allowed 49% foreign investment in the insurance sector, which includes insurance intermediaries.

FDI in the defence sector is allowed up to 74% through automatic route (from earlier 49%) for companies seeking new industrial licenses. FDI beyond 74% and up to 100% will be permitted under Government route.

In 2024, the Government relaxed rules to allow 100% foreign direct investment (FDI) in space sector.

In August 2019, the Government announced following reforms:

- 100% FDI under automatic route is permitted for sale of coal, for coal mining activities.
- 100% FDI through the automatic route allowed for ‘Contract Manufacturing’.
- 26% FDI under government route for uploading/streaming of News & Current Affairs through Digital Media, on the lines of print media.

Earlier Initiatives:

- In February 2019, the Government of India released the Draft National e-Commerce Policy which encourages FDI in the marketplace model of e-commerce.
- In December 2018, the Government of India revised FDI rules related to e-commerce. As per the rules 100% FDI is allowed in the marketplace-based model of e-commerce. Also, sales of any vendor through an e-commerce marketplace entity or its group companies have been limited to 25% of the total sales of such vendor.
- In September 2018, the Government of India released the National Digital Communications Policy, which envisages increasing FDI inflows in the telecommunications sector to US$ 100 billion by 2022.
- 100% FDI under automatic route for Single Brand Retail Trading
- 100% FDI under automatic route in Construction Development

8. Foreign Direct Investment Confidence (FDI) Index

The **Foreign Direct Investment Confidence (FDI) Index** prepared by A.T. Kearney is an annual survey which tracks the impact of likely political, economic, and regulatory changes on the foreign direct investment intentions and preferences of CEOs, CFOs, and other top executives of Global 1000 companies.

US remains most attractive country for foreign direct investment

13 April 2023 | Consulting.us | 3 min. read

The United States retained the top position for investment attractiveness for the 11th consecutive year in Kearney's Foreign Direct Investment (FDI) Confidence Index. Now in its 25th year, the FDI Confidence Index surveys global executives to rank markets that are likely to attract the most investment in the next three years.

Kearney, a Chicago-based management consultancy, said this year's report found cautious optimism in the economy among the surveyed business leaders, who represented $500 million+ revenue companies across 30 countries.

Eighty-two percent plan to increase their FDI in the next three years, up from 76% last year. Eighty-seven percent said FDI would be more important for their corporate profitability and competitiveness in the next three years, up from 83% last year. Nearly two-thirds (63%) remained more optimistic than pessimistic about the global economy, the same level as last year.

FDI CONFIDENCE INDEX

The Index is constructed using primary data from a proprietary survey of 500 senior executives of the world's leading corporations. The rankings are calculated based on questions about the respondents' companies' likelihood of making a direct investment in a market over the next 3 years. India stood at 16th rank in the year 2023. USA ranked 1st. India stood second among emerging countries.

1. Foreign Trade Act 1992

In India, the main legislation concerning foreign trade is the Foreign Trade (Development and Regulation) Act, 1992. The Act provides for the development and regulation of foreign trade by facilitating imports into, and augmenting exports from, India and for matters connected therewith or incidental thereto.

As per the provisions of the Act, the Government: -

- may make provisions for facilitating and controlling foreign trade
- may prohibit, restrict and regulate exports and imports, in all or specified cases as well as subject them to exemptions
- is authorised to formulate and announce an export and import policy and also amend the same from time to time, by notification in the Official Gazette
- is also authorised to appoint a 'Director General of Foreign Trade', DGFT for the purpose of the Act, including formulation and implementation of the export-import policy

In accordance with the provisions of the Act, a 'Directorate General of Foreign Trade (DGFT)' has been set up as an attached office of the Ministry of Commerce and Industry. It is headed by the Director General of Foreign Trade and is responsible for formulating and executing the Foreign Trade Policy/Exim Policy with the main objective of promoting Indian exports. The DGFT also issues licenses to exporters and monitors their corresponding obligations through a network of 32 regional offices.

The premier official organization entrusted with the work of collecting, compiling and publishing/disseminating trade statistics is the 'Directorate General of Commercial Intelligence and Statistics (DGCI&S)'. It is a subordinate office of the Ministry of Commerce and Industry, located at Kolkata. It provides various types of commercial information required by the policy makers, researchers, importers, exporters, traders as well as overseas buyers. It brings out a number of publications mainly on inland and coastal trade statistics, revenue statistics, shipping & air cargo statistics, etc.

2. India's Trade Composition

India is an exporter of Electronic Goods, Organic and Inorganic Chemicals, Petroleum Products, Engineering Goods and Drugs and Pharmaceuticals. India is an importer of Crude Oil, Iron & Steel, Organic and Inorganic Chemicals, Coal and Coke, Gold and Electronic Goods.

As per latest data released by the Ministry of Commerce in March 2021, the contribution of Services in overall trade (Services + Merchandise) is around 42 % for Exports and 24% for Imports.

The Ministry of Commerce & Industry has created an action-oriented plan, to bolster India's march towards becoming a **USD 5 trillion economy** before 2025. The focused plans will be on boosting services sector contribution to USD 3 trillion, manufacturing to USD 1 trillion and Agriculture to USD 1 trillion.

The Ministry of Commerce and Industry announces the integrated **Foreign Trade Policy (FTP)** in every 5 year. This is also called EXIM policy. This policy is usually updated every year with some modifications and new schemes.

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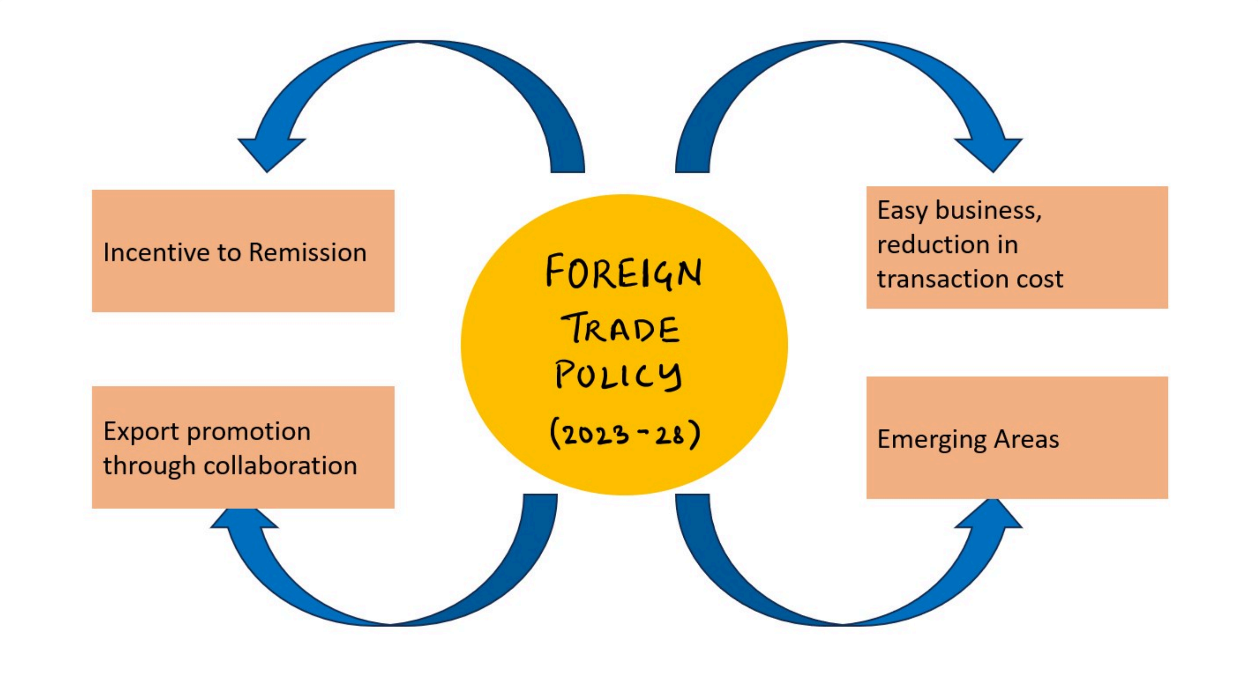
3. Foreign Trade Policy 2023-28



On 31 March 2023, the Ministry of Commerce and Industry announced the Foreign Trade Policy 2023 (FTP). The FTP 2023 is aimed at achieving a target of $2 trillion in exports for India by 2030.

Four key pillars of FTP 2023 are:

1. Incentive to Remission,
2. Export promotion through collaboration - Exporters, States, Districts, Indian Missions,
3. Ease of doing business, reduction in transaction cost and e-initiatives and
4. Emerging Areas – e-Commerce Developing Districts as Export Hubs and streamlining SCOMET policy.

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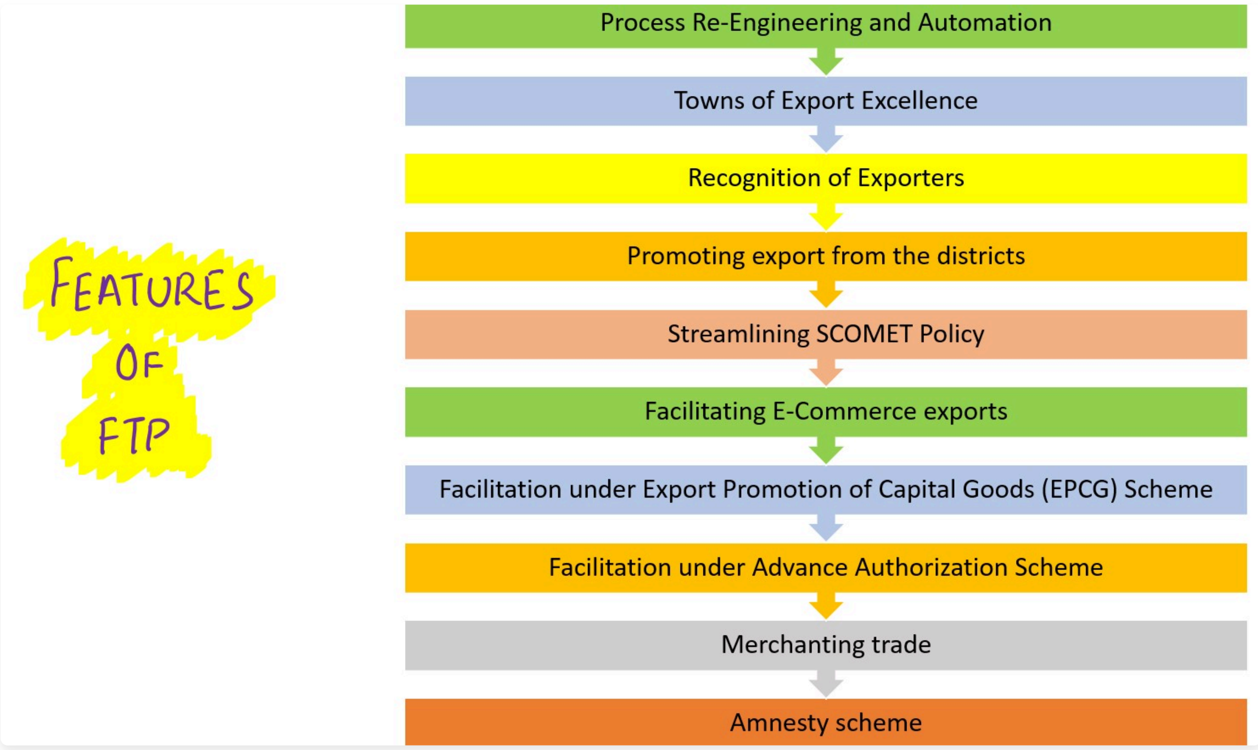
3. Foreign Trade Policy 2023-28



The saliant features of the Policy are discussed below:

1. Process Re-Engineering and Automation: One of the key highlights of FTP 2023 is greater faith being reposed on exporters through automated IT systems with a risk management system for various approvals. The policy emphasizes export promotion and development and moves away from an incentive regime to a regime that is facilitating, based on technology interface and principles of collaboration.

2. Towns of Export Excellence: Four new towns, namely Faridabad, Mirzapur, Moradabad, and Varanasi, have been designated as Towns of Export Excellence (TEE) in addition to the existing 39 towns. This move is expected to boost export-related activities in these towns and promote export-led growth.

3. Recognition of Exporters: The FTP 2023 recognizes exporter firms with 'status' based on export performance. These status holders will now be partners in capacity-building initiatives on a best-endeavor basis. 2-star and above status holders will also be encouraged to provide trade-related training based on a model curriculum to interested individuals. This initiative is expected to help build a strong export ecosystem and promote skill development among the export community.

4. Promoting export from the districts: The FTP 2023 aims at building partnerships with State governments and taking forward the Districts as Export Hubs (DEH) initiative to promote exports at the district level. Efforts to identify export-worthy products & services and resolve concerns at the district level will be made through an institutional mechanism – State Export Promotion Committee and District Export Promotion Committee at the State and District level, respectively. This initiative is expected to create a conducive environment for exports and accelerate the development of grassroots trade ecosystem.

5. Streamlining SCOMET Policy: The FTP 2023 places more emphasis on the "export control" regime as its integration with export control regime countries strengthens. There is a wider outreach and understanding of SCOMET (Special Chemicals, Organisms, Materials, Equipment, and Technologies) among stakeholders, and the policy regime is being made more robust to implement international treaties and agreements entered into by India.

6. Facilitating e-Commerce Exports: E-commerce exports are a promising category that requires distinct policy interventions from traditional offline trade. FTP 2023 outlines the intent and roadmap for establishing e-commerce hubs and related elements such as payment reconciliation, book-keeping, returns policy, and export entitlements. This initiative is expected to boost e-commerce exports and provide a boost to the digital economy.

7. Facilitation under Export Promotion of Capital Goods (EPCG) Scheme: The EPCG Scheme allows the import of capital goods at zero Customs duty for export production. The FTP 2023 aims to further rationalize the scheme and introduce some key changes to support various sectors. The **Prime Minister Mega Integrated Textile Region and Apparel Parks (PM MITRA)**

scheme has been added as an additional scheme eligible to claim benefits under the CSP (Common Service Provider) Scheme of Export Promotion Capital Goods Scheme (EPCG). The dairy sector will be exempted from maintaining Average Export Obligation, which will support the sector in upgrading its technology. Additionally, the FTP 2023 has added various products, such as Battery Electric Vehicles (BEV) of all types, Vertical Farming equipment, Wastewater Treatment and Recycling, Rainwater harvesting system and Rainwater Filters, and Green Hydrogen, to the Green Technology products list, which will now be eligible for a reduced Export Obligation requirement under the EPCG Scheme.

8. Facilitation under Advance authorization Scheme: The Advance Authorization Scheme provides duty-free import of raw materials for manufacturing export. Based on interactions with industry and Export Promotion councils, certain facilitation provisions have been added to the present FTP, which will help streamline the Advance Authorization Scheme and promote ease of doing business.

9. Merchanting trade: The FTP 2023 has introduced provisions for merchanting trade to develop India into a merchanting trade hub. Merchanting trade of restricted and prohibited items under the export policy would now be possible. Merchanting trade involves the shipment of goods from one foreign country to another foreign country without touching Indian ports, involving an Indian intermediary. This initiative is expected to create more opportunities for Indian intermediaries and promote trade activities in India.

10. Amnesty Scheme: To help alleviate the issues faced by exporters and reduce litigation, the government is introducing a special one-time Amnesty Scheme under the FTP 2023 to address default on Export Obligations. This scheme is intended to provide relief to exporters who have been unable to meet their obligations under EPCG and Advance Authorizations and are burdened by high duty and interest costs associated with pending cases. The Amnesty Scheme is expected to foster trust-based relationships and promote ease of doing business in India.

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4. Foreign Trade Policy 2015-20

Foreign Trade Policy 2015-2020

As per latest data released by the Ministry of Commerce in March 2021, the contribution of Services in overall trade (Services + Merchandise) is around 42 % for Exports and 24% for Imports.

The Ministry of Commerce & Industry has created an action-oriented plan, to bolster India's march towards becoming *a USD 5 trillion economy before 2025*. The focused plans will be on boosting services sector contribution to USD 3 trillion, manufacturing to USD 1 trillion and Agriculture to USD 1 trillion.

The Ministry of Commerce and Industry announces the integrated *Foreign Trade Policy (FTP)* in every 5 year. This is also called EXIM policy. This policy is usually updated every year with some modifications and new schemes.

The Foreign Trade Policy (FTP) 2015-20 was unveiled in April 2015 by then Ministry of Commerce & Industry. The policy was up to 31st March 2020. In view of the unprecedented current situation arising out of the pandemic novel COVID-19, the Govt. has decided to continue relief under various export promotion schemes by granting extension of the existing Foreign Trade Policy up to 31 March 2023 (extended for 6 months on 29 Sep 2022).

The new 5-year Foreign Trade Policy, 2015-20 seeks to make India a bigger player in global trade by doubling the overseas trade to USD 900 billion by 2019-20. In the year 2020-21, the exports were USD 487 billion. Further the Government has targeted to raise India's share in world exports (Goods and Services) from 2% to 3.5%.

FTP 2015-20 introduced 2 new schemes, namely *Merchandise Exports from India Scheme* (MEIS) for export of specified goods to specified markets and *Services Exports from India Scheme* (SEIS) for increasing exports of notified services. The objective of these schemes is to provide rewards to exporters to offset infrastructural inefficiencies and associated costs. Under MEIS and SEIS, duty credit scrips are granted as rewards. The Duty Credit Scrips and goods imported / domestically procured against them shall be freely transferable.

Earlier there were 5 different schemes (Focus Product Scheme, Market Linked Focus Product Scheme, Focus Market Scheme, Agri. Infrastructure Incentive Scrip, Vishesh Krishi Gramin Udyog Yojana) for rewarding merchandise exports with different kinds of duty scrips with varying conditions (sector specific or actual user only) attached to their use. Now all these schemes have been merged into a single scheme, namely **Merchandise Export from India Scheme (MEIS)** and there would be no conditionality attached to the scrips issued under the scheme.

Service Exports from India Scheme (SEIS) replaced the earlier scheme 'Served from India Scheme'. In June 2020, the validity of the SEIS was extended for 1 more year on account of COVID-19 pandemic. Under SEIS, the service providers of notified services are incentivized in the form of Duty Credit Scrips at the rate of 3% or 5% on their net foreign exchange earnings. These SEIS scrips are transferrable and can also be used for payment of a number of Central duties/ taxes including the basic customs duty.

RoDTEP scheme

In Aug 2021, the Government notified RoDTEP (Remission of Duties and Taxes on Exported Products) Scheme Guidelines and Rates. The RoDTEP scheme was announced in 2020 as a replacement for the Merchandise Export from India Scheme (MEIS), which was not compliant with the rules of the World Trade Organisation. The scheme would refund to exporters the embedded central, state and local duties or taxes that were so far not being rebated or refunded and were, therefore, placing India's exports at a disadvantage. It based on the globally accepted principle that taxes and duties should not be exported, and taxes and levies borne on the exported products should be either exempted or remitted to exporters.

Key Features

- To enable zero rating of exports by ensuring domestic taxes are not exported, all taxes, including those levied by States and even Gram Panchayats, will be refunded under the scheme.
- The rebates under RoDTEP are WTO-compliant as per legal advice, range from 0.5% to 4.3% of the Free on Board (FoB) value of outbound consignments.
- The lowest rate is offered on items like chocolates, toffees and sugar confectionary, while yarns and fibres have been granted the highest rate.
- Steel, pharma and chemicals have not been included under the scheme because their exports have done well without incentives.

It is a new scheme and is applicable from 01 January 2021, formed to replace the existing Merchandise Exports from India Scheme (MEIS). The US had earlier challenged MEIS in the World Trade Organisation (WTO), claiming the scheme to harm the American workers. A dispute panel in the WTO was ruled against India, which led to the emergence of the RoDTEP Scheme, to make sure that India stays WTO-compliant.

5. Foreign Trade Schemes

EPCG

EPCG (Export Promotion Capital Goods) Scheme helps in facilitating the import of capital goods for manufacturing quality goods and to augment the competitiveness of India's export. EPCG scheme enables the import of capital goods that are used in the pre-production, production, and post-production without the payment of customs duty. The measures have been adopted to nudge procurement of capital goods from indigenous manufacturers under the EPCG scheme by reducing specific export obligation to 75% of the normal export obligation. Measures have been taken to give a boost to exports of defense and hi-tech items.

Approved Exporter Scheme

Under the scheme, the manufacturers, who are also status holders (Three Star, Four Star etc.), will now be able to self-certify their manufactured goods in phases, as originating from India with a view to qualifying for preferential treatment under various forms of bilateral and regional trade agreements. This 'Approved Exporter System' will help manufacturer exporters considerably in getting fast access to international markets.

Niryat Bandhu Scheme

108 MSME clusters have been identified for focused interventions to boost exports. Accordingly, **Niryat Bandhu Scheme** has been galvanized and repositioned to achieve the objectives of 'Skill India'. The *Niryat Bandhu scheme* help entrepreneurs exploring business in exports through training, counselling and information sessions through the network of DGFT offices across India. The participants receive a certificate in Export Import Management under Niryat Bandhu Scheme post course completion.

Further in Dec 2018, The Commerce Ministry has formulated India's first ever **Agricultural Export Policy** with a focused plan to boost India's agricultural exports to USD 60 billion by 2022. The vision of the Agriculture Export Policy is to harness the export potential of Indian agriculture through suitable policy instruments and to make India a global power in agriculture and raise farmers' income.

A new scheme called *Transport and Marketing Assistance (TMA)* scheme has been launched for mitigating disadvantage of higher cost of transportation for export of specified agriculture products.

In Feb 2020, the Government announced the *NIRVIK* scheme. It will provide high insurance cover for exporters and reduce premium for small exporters. Also called the *Export Credit Insurance Scheme* (ECIS), the insurance guarantee could cover up to 90% of the principal and interest. *The Export Credit Guarantee Corporation* (ECGC) currently provides credit guarantee of up to 60 %.

Export Credit and Guarantee Corporation (ECGC)

The ECGC is wholly owned by Government of India. It was set up in 1957 with the objective of promoting exports from India by providing credit risk insurance and related services for exports. Over the years, it has designed different export credit risk insurance products to suit the requirements of Indian exporters. ECGC is essentially an export promotion organisation, seeking to improve the competitiveness of the Indian exports by providing them with credit insurance covers.

Export Promoting Zones (EPZ) and Special Economic Zones (SEZ)

EPZs are the industrial area which are special enclaves, separated from the Domestic Tariff Area (DTA), to provide an internationally competitive duty-free environment for export production. First Export Promoting Zone (EPZ) was set up in 1965 in Kandla, Gujarat.

In 1991, the reformed trade and individual Policy led to liberalization of the Indian economy and various measures were taken by the government for revamping and restructuring EPZs. The focus had been on delegating powers to zone authorities, providing additional fiscal incentives, simplifying policy provisions and providing greater facilities. The scope and coverage of the EPZ schemes was enlarged in 1992 by permitting the agriculture, horticulture and aqua-culture sector units. In 1994, trading, reengineering and reconditioning units were also permitted to be set up.

The EXIM Policy (1997-2002) has introduced a new scheme w.e.f. 1^{st} April 2000, for establishment of Special Economic Zones (SEZs) in different parts of the country. The SEZs are permitted to be set up in the minimum size of not less than 1000 hectares. The number of incentives both fiscal and non-fiscal has also been extended to the Units operating in SEZs. Several measures have been adopted to improve the quality of governance of zones. These include relaxation in the conditions for approval process and simplifying customs rules. SEZs Policy is thus, the most significant thrust towards ensuring the success of export processing zones. The conversion of EPZ into SEZ started from November 1, 2000; the EPZ at Kandla, Santa Cruz (Mumbai), Cochin, and Surat were converted into SEZs.

In order to provide a significant thrust to the policy, the government enacted the SEZ Act 2005. EXIM Policy refers to Export and Import (EXIM) Policy. Later, EXIM Policy got incorporated into the comprehensive Foreign Trade Policy.

The **Export Oriented Units** (EOUs) scheme introduced in early 1981, is complementary to the SEZ scheme. It adopts the same production regime but offers a wide option in locations with reference to factors like source of raw materials, ports of export, hinterland facilities, availability of technological skills, existence of an industrial base and the need for a larger area of land for the project.

The *Baba Kalyani* led committee (constituted by the Ministry of Commerce & Industry) to study the existing SEZ policy of India submitted its report in November 2018. The objectives of the committee were to evaluate the SEZ policy and make it WTO compatible.

Trade Infrastructure for Export Scheme (TIES)

The scheme provides financial assistance in the form of grant-in-aid to Central/State government agencies for setting up or for up-gradation of export infrastructure like border haats, cold chains, dry ports, etc. The Central and State Agencies, including Export Promotion Councils, Commodities Boards, SEZ Authorities and Apex Trade Bodies recognized under the EXIM Policy of Government of India; are eligible for financial support under this scheme. It was launched in 2017. It is a central sector scheme.

Foreign Direct Investment Confidence (FDI) Index

The Foreign Direct Investment Confidence (FDI) Index prepared by A.T. Kearney is an annual survey which tracks the impact of likely political, economic, and regulatory changes on the foreign direct investment intentions and preferences of CEOs, CFOs, and other top executives of Global 1000 companies.

The Index is constructed using primary data from a proprietary survey of 500 senior executives of the world's leading corporations. The rankings are calculated based on questions about the respondents' companies' likelihood of making a direct investment in a market over the next 3 years. India stood at 16^{th} rank in the year 2019, which was 11^{th} rank in 2018. USA ranked 1^{st}.

For 2021, India has dropped out of Kearney's FDI Index (also in 2020). Top 3 were USA, Canada and Germany.

Market Access Initiative

Market Access Initiative Scheme is formulated to act as a catalyst to promote India exports on a sustained basis. There are provisions for supporting individual exporters for product registration and testing charges for engineering pharmaceuticals products abroad. Under the scheme ,assistance is provided to the organizations of Central State Governments Export Promotion Councils, Registered Trade Promotion organizations, Commodity Boards, recognized Apex Trade Bodies and Recognized Industrial Clusters.

6. EXIM Bank

EXIM
BANK

The Export–Import Bank of India is the premier export finance institution in India, established in 1982 under Export-Import Bank of India Act 1981. Since its inception, Exim Bank of India has been both a catalyst and a key player in the promotion of cross border trade and investment. The Roles of EXIM bank are described in the figure.

Commencing operations as a source of export credit, the Exim Bank India supports organizations in through a wide range of products and services offered at all stages of the business cycle, starting from import of technology and export product development to export production, export marketing, pre-shipment and post-shipment and overseas investment.

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6. EXIM Bank

The EXIM Bank's functions are segmented into several operating groups including:

- **Corporate Banking Group** handles a variety of financing programmes for Export Oriented Units (EOUs), Importers, and overseas investment by Indian companies.
- **Project Finance / Trade Finance Group** handles the entire range of export credit services such as supplier's credit, pre-shipment Agriculture Business Group, to spearhead the initiative to promote and support Agricultural exports. The Group handles projects and export transactions in the agricultural sector for financing.
- **Small and Medium Enterprise** handles credit proposals from SMEs under various lending programmes of the Bank.
- **Export Services Group** offers variety of advisory and value-added information services aimed at investment promotion.
- **Export Marketing Services Bank** offers assistance to Indian companies, to enable them to establish their products in overseas markets. The idea behind this service is to promote Indian export. Export Marketing Services covers wide range of export-oriented companies and organizations. EMS group also covers Project exports and Export of Services.
- **Support Services groups** includes Research & Planning, Treasury and Accounts, Loan Administration, Internal Audit, Management Information Services, Information Technology, Legal, Human Resources Management and Corporate Communications.

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7. EPZ and SEZ

Industrial policy Resolutions were brought in years 1948, 1956, 1973, 1977, 1980, 1990. The New Industrial policy was brought in 1991 during economic reforms.

The Industrial Policy Resolution of 1948 marked the beginning of the development of Indian industrial policy. During the period of Jawaharlal Nehru, international cooperation was promoted in specific sectors and foreign investment was encouraged. First Export Promoting Zones (EPZ) was set up in 1965 in Kandla, Gujarat. An EPZ is an industrial area that constitutes enclaves with regards to customs tariffs and the commercial code in vigor in the host country.

In 1991, the reformed trade and individual Policy led to liberalization of the Indian economy and various measures were taken by the government for revamping and restructuring EPZs. The focus had been on delegating powers to zone authorities, providing additional fiscal incentives, simplifying policy provisions and providing greater facilities. The scope and coverage of the EPZ schemes was enlarged in 1992 by permitting the agriculture, horticulture and aqua-culture sector units. In 1994, trading, reengineering and reconditioning units were also permitted to be set up.

The EXIM Policy (1997-2000) has introduced a new scheme from April 1, 2000 for establishment of Special Economic Zones (SEZs) in different parts of the country. The SEZs are permitted to be set up in the minimum size of not less than 1000 hectares. The number of incentives both fiscal and non-fiscal has also been extended to the units operating in SEZs. Several measures have been adopted to improve the quality of governance of zones. These include relaxation in the conditions for approval process and simplifying customs rules. SEZs Policy is thus the most significant thrust towards ensuring the success of export processing zones.

The conversion of EPZ into SEZ started from November 1, 2000; the EPZ at Kandla, Santa Cruz (Mumbai), Cochin, and Surat have been converted into SEZs. In 2003, other exiting EPZs namely Noida and Falta began converting into SEZs.

In order to provide a significant thrust to the policy, the government enacted the SEZ Act 2005. The Act became operative in February 2006 after the SEZs Rules were framed and notified. In 2023, the SEZs (Fifth Amendment) Rules, 2023 were notified.

An SEZ (Special Economic Zone) is a designated duty-free area considered to be outside the national customs territory for trade purposes, including duties and tariffs. Both private and public entities, including joint ventures and State Governments or their agencies, are eligible to establish an SEZ. It encompasses various types of zones, such as Export Processing Zones (EPZ), Free Zones (FZ), Industrial Estates (IE), Free Trade Zones (FTZ), Free Ports, Urban Enterprise Zones, and others.

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7. EPZ and SEZ

The **Export Oriented Units (EOUs)** scheme introduced in early 1981, is complementary to the SEZ scheme. It adopts the same production regime but offers a wide option in locations with reference to factors like source of raw materials, ports of export, hinterland facilities, availability of technological skills, existence of an industrial base and the need for a larger area of land for the project.

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7. EPZ and SEZ

The **Baba Kalyani led committee** (constituted by the Ministry of Commerce & Industry) to study the existing SEZ policy of India submitted its report in Nov 2018. The objectives of the committee were to evaluate the SEZ policy and make it WTO compatible, suggest measures for maximizing utilisation of vacant land in SEZs, suggest changes in the SEZ policy based on international experience and merge the SEZ policy with other Government schemes like coastal economic zones, Delhi-Mumbai industrial corridor, national industrial manufacturing zones and food and textiles parks.

8. Export Finance

Export finance refers to financial assistance extended by banks and other financial institutions to businesses for the shipping of products outside a country or region. Export financing enables MSMEs to expand its reach to a global audience. An exporter should first gain understanding of some documents commonly required by export finance institutions. These documents are mandatory requirements for most types of export finance assistance.

Export finance assistance is extended at various stages of exports. Loans or advances are granted by financial institutions to exporters for financing the purchase, processing, manufacturing or packing of goods prior to shipment which is known as pre-shipment credit. Also, these are granted by financial institutions to exporters from the date of extending credit after shipment of goods to the date of realization of export proceeds which is known as post shipment credit .

Banks and financial institutions extend factoring services to exporters where it buys the accounts receivable of the exporter at a discount in exchange for immediate money.

8. Export Finance

The ECGC is wholly owned by Government of India. It was set up in 1957 with the objective of promoting exports from India by providing credit risk insurance and related services for exports. Over the years it has designed different export credit risk insurance products to suit the requirements of Indian exporters. ECGC is essentially an export promotion organisation, seeking to improve the competitiveness of the Indian exports by providing them with credit insurance covers.

The ECGC has introduced export credit insurance schemes to meet the requirements of commercial banks extending export credit. The insurance covers enable the banks to extend timely and adequate export credit facilities to the exporters. ECGC keeps its premium rates at the optimal level.

ECGC provides:

- A range of insurance covers to Indian exporters against the risk of non–realisation of export proceeds due to commercial or political risks.
- Different types of credit insurance covers to banks and other financial institutions to enable them to extend credit facilities to exporters.
- Export Factoring facility for MSME sector which is a package of financial products consisting of working capital financing, credit risk protection, maintenance of sales ledger and collection of export receivables from the buyer located in overseas country.

8. Export Finance

The **Export promotional Councils** (EPC) are authorities which are basically promoting, supporting and assisting firms in entering the International markets and realising their optimum potential from given resources. They also provide guidance and assistance to the exporters. The EPCs are non-profit organisation registered as a company or society. Each Export promotional council is responsible for his particular group of products.

9. India's Ranking in Global Indices

As reported in 2020, India has made a leap of 14 ranks in the World Bank's Ease of Doing Business Ranking in 2020 to be ranked at 63rd place (In 2019, India's was at 77 rank). In September 2021, the World Bank discontinued **Ease of Doing Business Index (EBDI)**, after 18 years.

This ranking is prepared based on the list of 10 indicators, given below:

1. **Starting a business** – Procedures, time, cost and minimum capital to open a new business.
2. **Dealing with construction permits** – Procedures, time and cost to build a warehouse.
3. **Getting electricity** – Procedures, time and cost required for a business to obtain a permanent electricity connection for a newly constructed warehouse.
4. **Registering property** – Procedures, time and cost to register commercial real estate.
5. **Getting credit** – Strength of legal rights index, depth of credit information index.
6. **Protecting investors** – Indices on the extent of disclosure, extent of director liability and ease of shareholder suits.
7. **Paying taxes** – Number of taxes paid, hours per year spent preparing tax returns and total tax payable as share of gross profit.
8. **Trading across borders** – Number of documents, cost and time necessary to export.
9. **Enforcing contracts** – Procedures, time and cost to enforce a debt contract.
10. **Resolving insolvency** – The time, cost and recovery rate (%) under bankruptcy proceeding.

9. India's Ranking in Global Indices

As reported in Sep 2023, India has ranked 40 in 2023 in the **Global Innovation Index**. The Global Innovation Index (GII) is an annual ranking of countries by their capacity for, and success in, innovation. It is published by Cornell University, INSEAD, and the World Intellectual Property Organization (WIPO), in partnership with other organisations and institutions.

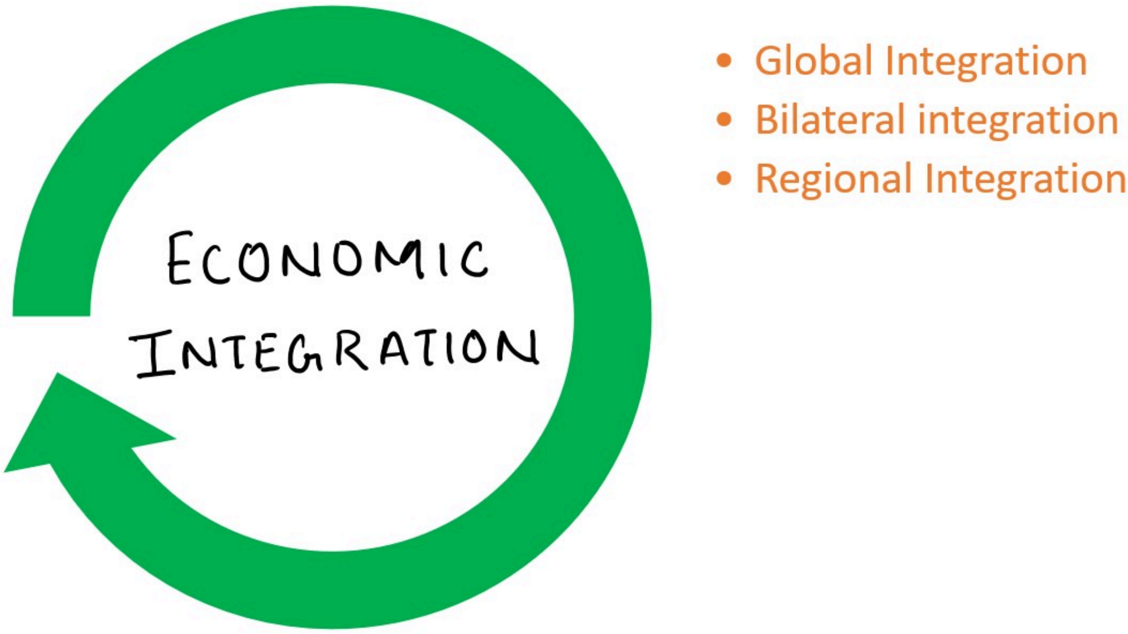
As reported in April 2023, India has ranked 38 in the **Logistics Performance Index (LPI)**. The Logistics Performance Index (LPI) is an interactive benchmarking tool created by the World Bank to help countries identify the challenges and opportunities they face in their performance on trade logistics and what they can do to improve their performance.

The logistics performance (LPI) is the weighted average of the country scores on the 6 key dimensions:

1. Efficiency of the clearance process (i.e., speed, simplicity and predictability of formalities) by border control agencies, including customs2. Quality of
2. trade and transport related infrastructure (for e.g., ports, railroads, roads, information and technology)
3. Ease of arranging competitively priced shipments
4. Competence and quality of logistics services (e.g., transport operators, customs brokers)
5. Ability to track and trace consignments
6. Timeliness of shipments in reaching destination within the scheduled or expected delivery time.

1. Introduction

Economic integration refers to agreements and collaborations among nations or regions that prioritize member countries' economic ties. It typically involves reducing trade barriers, promoting economic cooperation, and facilitating the movement of goods, services, and resources between member states.



There are 3 primary approaches to economic integration:

1. **Global Integration:** Involves worldwide cooperation among nations facilitated through entities like the World Trade Organization (WTO). It focuses on creating global trade agreements, policies, and standards that impact all participating countries.

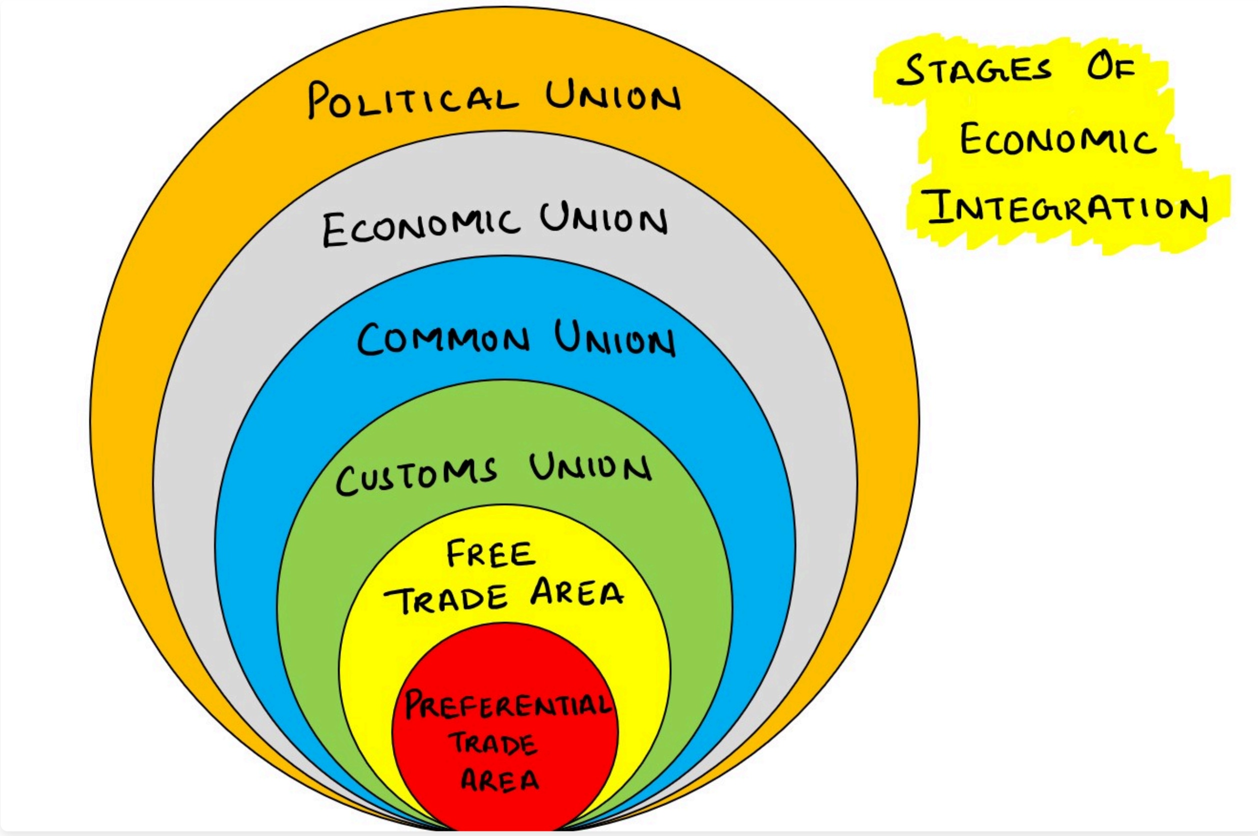
2. **Bilateral Integration:** Occurs when two countries opt for closer cooperation, often involving agreements to reduce tariffs, enhance trade, or facilitate specific economic exchanges between the paired nations.

3. **Regional Integration:** Involves a group of neighboring countries agreeing to collaborate economically. The European Union is a prime example of regional integration, where member nations form a unified economic entity with common policies, trade arrangements, and regulatory frameworks.

These trade groups, whether at a global, bilateral, or regional level, significantly influence strategies for multinational enterprises (MNEs). They define market size within the region, establish trade regulations, and outline the operational guidelines that companies must follow when operating within the integrated area.

2. Stages of economic integration

Regional trading blocs differ significantly in form and function. The most important characteristic to international businesses is the extent of economic integration among a bloc's members because it affects exporting and investment opportunities available to firms from member and nonmember countries.



There are six different forms of regional economic integration:

1. Preferential Trade Area
2. Free trade area
3. Customs union
4. Common market
5. Economic union
6. Political union

2. Stages of economic integration

Parties to this economic integration arrangement trade on preferential terms. Parties reduce tariff rates on agreed list of goods they trade between themselves. They are unilateral trade preferences. It is the first stage of economic integration.